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MBA PROFESSIONAL REPORT

Developing Istanbul into a Regional Business Hub

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13. ABSTRACT

Globalization has urged many big corporations to operate in foreign countries in order to access world markets and produce at lower costs. Many countries and cities compete with each other for becoming business hubs in their regions in order to benefit from huge FDI inflows. In this study we used the Value Net analysis to uncover Istanbul's position by the means of attracting foreign investors, and the SWOT (Strengths-Weaknesses-Opportunities-Threats) analysis to examine Istanbul's capabilities, advantages, weaknesses, threats and opportunities on its way to become a regional business hub. We found that Istanbul has a great potential and many advantages to become a regional business hub for MNCs that want access to huge markets in Europe, Caucasia and the Middle East as well as the emerging market in Turkey itself. However, Istanbul also possesses several weaknesses and faces some threats causing the inward FDI flows remain at much lower than the desired levels. Political and economic stability is the biggest obstacle facing Turkey (and Istanbul) in terms of attracting foreign investors. We recommend that the governments should avoid populist policies and focus more on structural and economic reforms.

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DEVELOPING ISTANBUL INTO A REGIONAL BUSINESS HUB

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ABSTRACT

Globalization has urged many big corporations to operate in foreign countries in order to access world markets and produce at lower costs. Many countries and cities compete with each other for becoming business hubs in their regions in order to benefit from huge Foreign Direct Investment (FDI) inflows. In this study we used the Value Net analysis to uncover Istanbul's position by the means of attracting foreign investors, and the SWOT (Strengths-Weaknesses-Opportunities-Threats) analysis to examine Istanbul's capabilities, advantages, weaknesses, threats and opportunities on its way to become a regional business hub. We found that Istanbul has a great potential and many advantages to become a regional business hub for Multi National Corporations (MNCs) that want access to huge markets in Europe, Caucasia and the Middle East as well as the emerging market in Turkey itself. However, Istanbul also possesses several weaknesses and faces some threats causing the inward FDI flows remain at much lower than the desired levels. Political and economic stability is the biggest obstacle facing Turkey (and Istanbul) in terms of attracting foreign investors. We recommend that the governments should avoid populist policies and focus more on structural and economic reforms.

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TABLE OF CONTENTS

LIST OF FIGURES

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LIST OF TABLES

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I. INTRODUCTION

Globalization has acquired considerable attention since the 1980s. It refers to the increasing integration of economies around the world, particularly through trade and financial flows. The term also refers to the movement of people (labor), knowledge (technology), production facilities and supply chains across international borders. Some view it as a key process for future world economic development, and also as inevitable and irreversible. Others regard it with hostility, believing that it increases inequality within and among nations, threatens employment and living standards and thwarts social progress. The fact is that globalization has led to a significant increase in foreign direct investment (FDI). Worldwide exports increased from 12% of world GDP in 1962 to more than 25% of world GDP (totaling $28.9 trillion) in 1998 (World Development Report 1999/2000). The number of companies working internationally is growing enormously day-by-day.

There are many factors that encourage organizations to engage in international businesses. (Waters, 1999)

New Opportunities in the New Growing Markets: Consumer demand is growing faster in some regions of the world than in others. These regions are becoming wealthier; they are demanding more goods and are therefore more attractive. Foreign companies recognize the new opportunities in these growing markets and are encouraged to produce and sell their products in these areas.

Economies of Scale: Many manufacturing operations depend on large-scale and steady production. Sometimes, the best production scale is larger than the demand from one single domestic market. The result is international production facilities with economies of scale giving lower unit and distribution costs.

Greater Demands on Suppliers and Outsourcing: Many organizations focus on their core competencies and choose to outsource other operations. In most cases local suppliers may not meet the demand, and companies may have to look elsewhere to find the best sources, which often can be found in foreign countries.

Removal of Trade Barriers: GATT (General Agreement on Tariffs and Trade) is one of the major steps that have enabled global free trade. The agreement was designed to provide an international forum that encouraged free trade between member states by regulating and reducing tariffs on traded goods. This led countries to create free trade centers, such as the European Union and the North American Free Trade Area.

Developments in IT (Information Technology) and Communications: Huge developments in IT and communication systems have created a smaller world. The Internet, GPS, RFID, video conferencing and wireless communication systems have changed the way organizations exchange information and have enabled faster and easier global communication.

A. STRATEGIC MOTIVES FOR INTERNATIONAL INVESTMENT

According to Dunning (1998), there are four generic types of strategic motives for international investment: Market, efficiency, resource and asset-seeking FDI.

The main motivation for the market to seek MNCs (Multinational Companies or Corporations) is to have access to new and bigger consumer markets. When the transportation costs and tariff barriers for an attractive market are high, companies choose to produce and distribute in the market country. The advantage for the company by doing so is that it will have easier and more cost-effective access to an international market.

Efficient, resource-seeking MNCs are trying to minimize their costs by investing abroad. They are producing in foreign countries with lower labor costs, essential raw materials, lower energy costs and lower commodity and real estate prices.

In asset-seeking strategy, innovative activities are carried out within international research networks to gain distinctive knowledge assets and technological capabilities. MNCs with this kind of strategy choose countries that have high technology, distinctive universities and research centers, and high-level human capital. As an advantage MNCs will be able to exchange technologies, patents and new products or production techniques.

These strategies cannot be isolated. A company can pursue two or three or even all of the strategies mentioned above at the same time. MNCs seek markets with higher

consumer demands, locations with essential energy resources and raw materials, lower labor and distribution costs and improved infrastructure. In other words, MNCs are increasingly making investment location decisions based on a regional or global strategy that integrates market, efficiency and asset-seeking motives. The ideal location should offer access to markets and an efficient production base, as well as technological assets that can contribute to the company's network of critical capabilities across the world (Loewendahl & Ertugal-Loewendahl, 2001).

B. BECOMING A REGIONAL BUSINESS AND LOGISTICS HUB

FDI has significant affects on the economy of the host country. It affects the production, income, employment, technology, exports, prices, quality of life, imports, economic growth and overall welfare of the recipient country. And these are positive impacts for the host country most of the time. Today, many countries have ambitions to become a business hub in their region. There is a big competition between the nations to attract international businesses and become regional business hubs in their regions.

Within Asia, China is touted to be a major growth locomotive. The Chinese government has recognized that transport and logistics is an important pillar of the country's economic growth (International Enterprise Singapore, 2002). Many other countries, such as Singapore, Hong Kong, Taiwan, Malaysia, Thailand, and the Philippines are positioning themselves to be logistics hubs.

On the other hand, in Eastern Europe; Czech Republic, Hungary and Poland are the furthest along in economic development. These three nations are positioning themselves for higher value added jobs, and are in an intensive competition in attracting foreign investors. Companies setting up manufacturing facilities here are doing so to serve a European customer base, rather than for export to other regions.

C. BACKGROUND

1. Turkey

Turkey enjoys a unique location at the crossroads between the East and the West, overlapping Europe and Asia both geographically and culturally. Turkey's proximity to big markets in Europe and emerging markets in the Middle East and Central Asia increases its potential as a logistics hub.

Turkey is the largest economy in Eastern Europe, the Balkans, the Black Sea basin and the Middle East. It is the European Union's sixth biggest trading partner and the world's seventh largest emerging economy (Loewendahl, Ertugal-Loewendahl, 2001).

Turkey's improved relationships and customs agreement with the EU (European Union), and its linguistic, religious and cultural ties with the Turkic republics (Azerbaijan, Uzbekistan, Kyrgyzstan, Turkmenistan and Kazakhstan) in Central Asia and Caucasia, have a special value and privilege. Turkey has a unique opportunity to establish very close economic cooperation with these Turkic countries and to provide technical expertise, investment and trade cooperation to help exploit their vast resources of oil, natural gas and other precious metals. Hence Turkey stands as the perfect gateway for foreign investors searching for business opportunities in Europe, the Balkans, Caucasia, the Middle East and Central Asia. Furthermore, there is a considerable business volume in terms of trade with Russia and the Black Sea countries (Foreign Investors Association of Turkey, 2004).

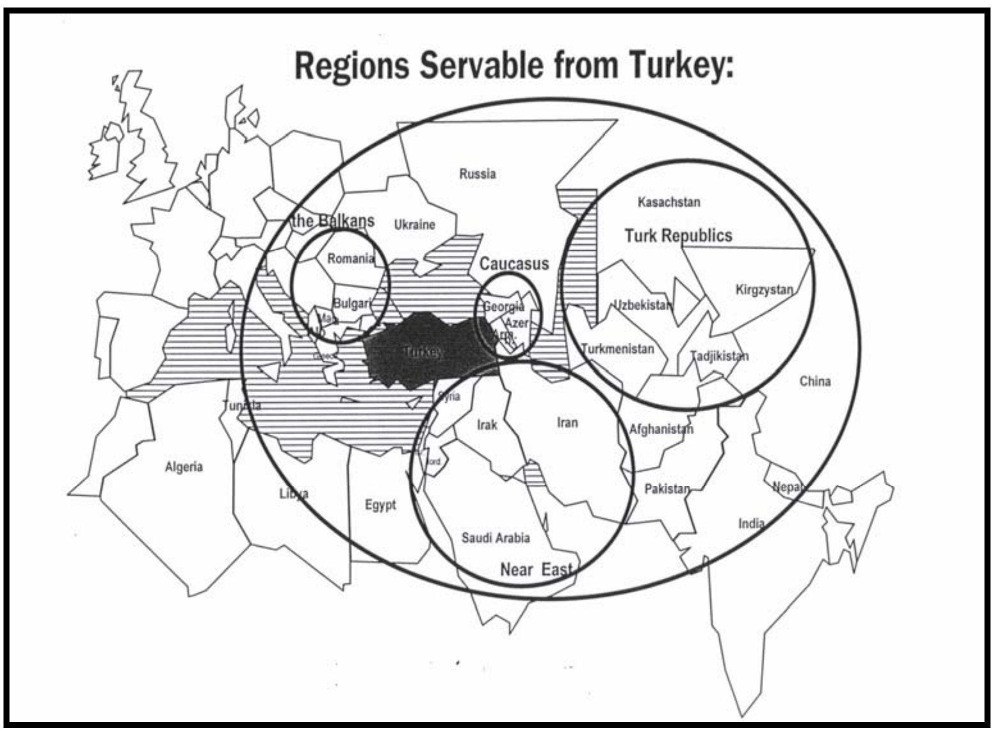

Figure 1. Regions servable from Turkey (From www.yased.org.tr date accessed 12/5/2004)

Despite these unique advantages Turkey has not performed well enough to attract a high level of MNC investment in Turkey. "The stock of FDI in Turkey was only $300 million in 1971, and up until 1980 the average annual flow of FDI was only $90 million. It was only with a shift in Turkey from a protectionist trade regime (import substitution strategy) to an export-oriented economic liberalization in the mid 1980s that FDI increased significantly." (Loewendahl, Ertugal-Loewendahl, 2001).

As Figure 2 shows, the annual flow of FDI in Turkey grew rapidly from the 1980s to the 1990s. Although there is a rapid increase in the late 90s, we believe that Turkey has received much less FDI flows than it deserved.

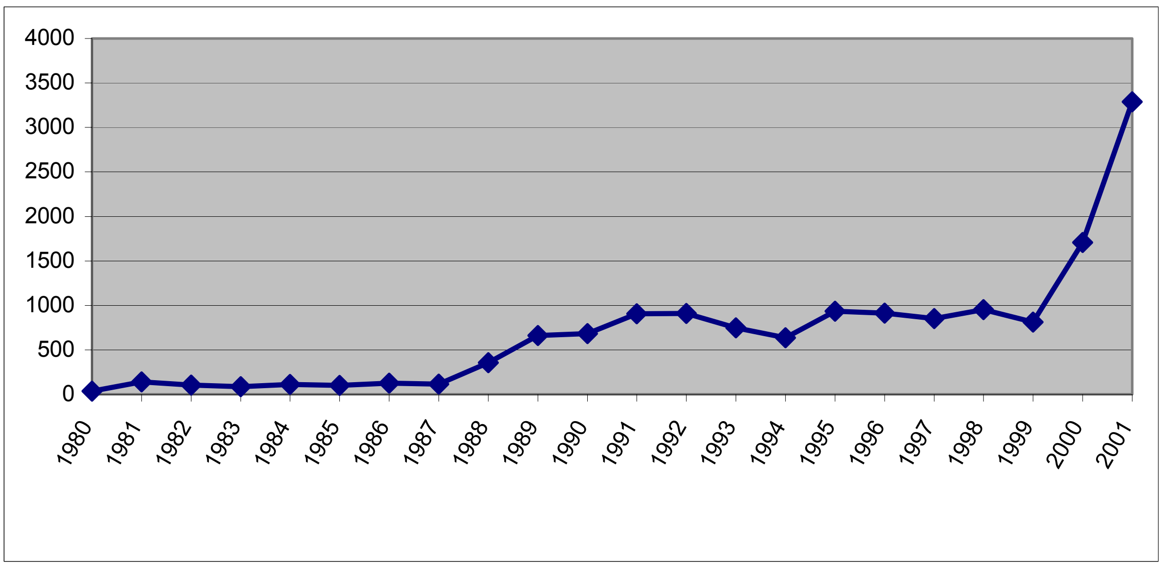

Figure 2. FDI flows in Turkey, 1980-2001, US$ million

Source: Derived from the data from www.treasury.gov.tr (date accessed 12/05/2004)

At the beginning of the 1980s, the government initiated new reforms, with the purposes of minimizing state intervention, establishing a free market economy and integrating with the global economy. With these new reforms, Turkey switched its economic strategy from "import substituting industrialization" to "export-oriented growth strategy" (Foreign Economic Relations Board, 2003), which means the introduction of

liberalization in financial markets, and more emphasis on foreign trade. As a result, import regime was liberalized to a great extent and export incentives were initiated.

Due to liberalization policies, the activities of foreign investors accelerated in the 1980s. Main foreign investment areas were telecommunications, textiles, agriculture, electronics, food, tobacco, automotive industries and banking. The cumulative amount of foreign investment increased from $35 million to $2.5 billion between the years 1980 and 1990.

The reforms spurred solid growth, but growth that has been punctuated by sharp recessions and financial crises in 1994, 1999, and 2001. Turkey's failure to pursue additional reforms, combined with large and growing public sector deficits, resulted in high inflation, increasing macroeconomic volatility and a weak banking sector. Turkey has suffered hyperinflation between the years 1980 and 2001, and several disinflation attempts by the government have failed. Some major reasons for high inflation in Turkey were political instability, high public sector deficits, high military expenditures associated with geopolitical reasons, massive infrastructure investments and populist policies of governments (Kibritcioglu, 2001).

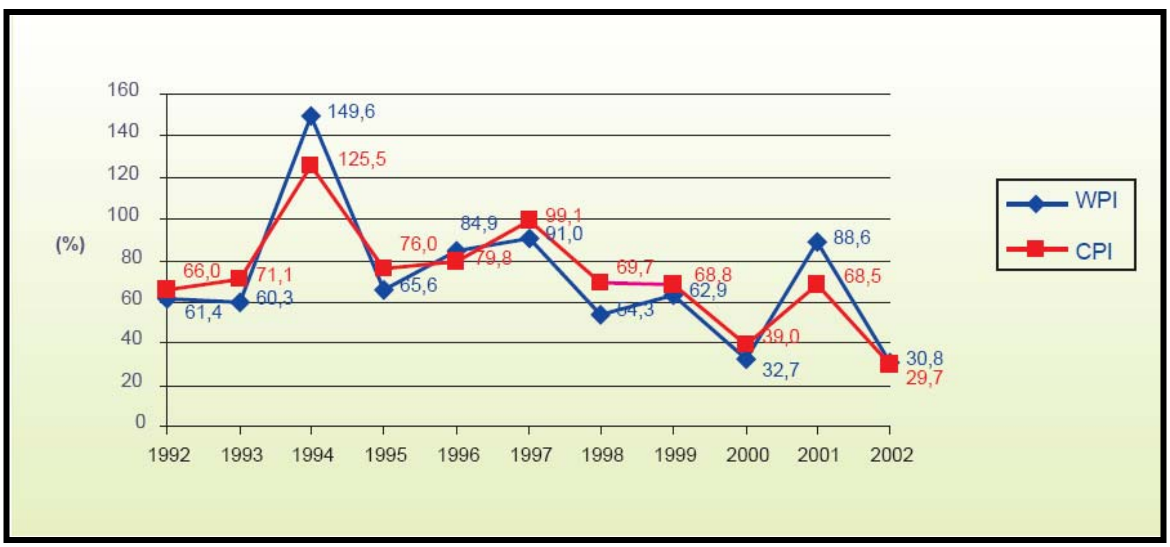

Figure 3. Inflation trend in Turkey, 1992-2002

Source: From Foreign Economic Relations Board (http://www.deik.org.tr date accessed 12/05/2004)

After suffering a financial crisis and severe recession in 2001, the Turkish economy is well on the way to recovery. The single-party AKP government elected in November 2002 has continued to make progress with economic and political reforms. The new government's economic program contains strong commitments to disinflation, sustainable growth, privatization, FDI and public sector reforms.

As a result of the firm implementation of sound economic programs and effective structural reforms, a significant success was accomplished in the struggle against inflation. The economy grew annually by 7.8% in 2002, 5.9% in 2003 and 12.4% in the first quarter of 2004. The main drivers behind growth are export-led production and an increase in domestic demand. Consumer Price Inflation (CPI) fell from 73.2% in January 2002 to 9.6% as of July 2004.

Turkey offers many advantages to foreign investors. Its large domestic market of 70 million people desiring high quality products; a qualified manual and technical labor force with low labor costs and high productivity; and well-developed utility and transportation facilities, along with a geographic and economic location close to nearby major markets of the world, are only some of Turkey's many advantages.

2. Istanbul

Throughout history, Istanbul has been a city at the right place at the right time. It is the only city in the world built on two continents, and serves as a bridge between Europe and Asia, both culturally and geographically. Istanbul is the business and economic center of Turkey. Though not the administrative capital of Turkey, Istanbul, in terms of decision-making and administration, is the economic and cultural heartland of the modern Republic of Turkey. It is the major seaport of Turkey as well as its largest and richest city. As the hub of Turkey's industry, the largest companies, banks, insurance and stock exchange firms, advertising companies and mass media (including most of the national television and radio stations, and newspapers) are all located in Istanbul (Erdemir, 2003).

As the business and industry hub, Istanbul generates 40% of Turkey's GDP and 45% of total taxes paid in Turkey. 40% of Turkey's total industry is located in and around Istanbul.

Istanbul is readily accessible from all parts of the world, served by 56 international airlines. Every major European airport is only 2-4 flight hours from Istanbul. There are frequent direct flights to Istanbul from most major cities, such as New York, Chicago, Tel Aviv, Johannesburg, Tokyo, Beijing and Bangkok. All these are connected to a vast network of domestic and international air routes. Figure 4 shows the flight connections to or from Istanbul.

Figure 4. Flight connections to or from Istanbul

Ataturk International Airport in Istanbul is one of the biggest airports in Europe. Its current passenger capacity is 14 million per year, and with ongoing construction and expansion the capacity will reach 20 million in the near future. With its high tech

infrastructure, improved security systems, commodities, ease of customs process and large passenger capacity, Ataturk International Airport is a candidate for becoming an international hub airport for flight connections.

For a logistics hub, one of the most important requirements is the diversity of the transportation modes available in and around the city. There are many transportation types available within Istanbul, including intermodal connections between air, rail, sea and highways. Trucks are the most-used mode of transportation due to the availability of an improved highway system. Having coastal access to the Black Sea as well as to the Marmara Sea, Istanbul provides connection between land and sea transportation.

The 2000 census shows that the population in Istanbul is over 10 million. With this high population, Istanbul is the tenth most-crowded city in the world (2004). Population density is also high: 1,928/km^2 according to the 2000 consensus. The city serves the worldwide community with 12 conference centers with a total capacity of 35,000 people, and 240 hotels (total capacity: 40,000 beds). Every year Istanbul hosts people from all around the world for international summits, conferences, film and music festivals and sports activities. Istanbul is also very attractive to tourists. Every year, 2 million tourists (on average) visit Istanbul. In 1995, one out of every four foreign visitors to Turkey visited Istanbul.

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II. LITERATURE REVIEW

Due to the accelerating effects of high globalization, the number of internationalized companies is growing fast. Many companies, to get access to new and emerging markets, gain competitive advantage, and produce with higher efficiency and economies of scale, are trying to internationalize their operations in foreign companies.

“In modern international competition, a firm cannot rely on its national circumstances to sustain its competitive advantage. A firm must selectively add to its advantages or offset home-based disadvantages through activities in other nations. This is what a global strategy is all about.” (Porter, 1990)

FDI (Foreign Direct Investment) is considered to be the outcome of broad corporate strategies and investment decisions of profit-maximizing firms facing world-wide competition, where significant differences in cost structures, due to factor productivity and remuneration differentials across countries, justify cross-border investment and production relocation (Mello, 1997). There are a lot of studies on the decision-making process of the MNCs for operating in other countries. The Eclectic Paradigm introduced by Dunning (1979, 1980 and subsequently reformulated in 1988, 1995 and 1997) is one of the most-referenced models used to explain the decision-making process of a company before it internationalizes.

A. THE ECLECTIC PARADIGM

The Eclectic Paradigm of Dunning (1979, 1980) proposes that the undertaking of FDI is determined by the realization of three groups of advantages:

(1) Ownership advantages are specific to the company and are related to the accumulation of intangible assets, technological capacities or product innovations.

(2) Internalization advantages stem from the capacity of the firm to manage and coordinate activities internally in the value-added chain. They are related to the integration of transactions into multinational hierarchies through FDI.

(3) Location advantages refer to the institutional and productive factors present in a particular geographic area. They arise when it is better to combine products manufactured in the home country with irremovable factors and intermediate products of another location.

In other words, a firm must own or control a unique mobile asset (e.g., a patent or trademark) it wishes to exploit (the ownership advantage); it must be cost efficient to exploit the asset abroad in addition to, or instead of in, the firm's home country (the location advantage); and it must be in the firm's interest to control the asset's exploitation itself, rather than contracting out use of the asset to an independent foreign firm (the internationalization advantage). For instance, General Motors will engage in FDI when it has a design for a car which could be manufactured abroad more efficiently than at home and whose production the firm wishes to control through ownership of the factory in which it is made (Hanson, 2001).

Galan and Gonzalez-Benito (2001), on their recent research based on the Eclectic Paradigm, analyzed the main ownership, internationalization and location factors that affect the internalization processes of MNCs (103 Spain-originated MNCs). Two of the main questions they asked were: Why internationalize? (ownership factors) and Where to undertake FDI? (location factors).

1. Ownership Factors (Why Internationalize?)

For the ownership factors, the company analyzes its own capabilities, such as experiences, human capabilities, common reputation, financial power and current agreements with other internationalized or foreign companies. According to the result of the analysis, the company chooses whether to invest or not invest abroad.

> Ownership factors with the highest determinant power are related to the existence of specific intangible assets in the internationalized company. Thus, the decision to enter foreign markets is especially prompted by the experience accumulated in local markets and the ability to learn from such experiences, the technological and innovative capabilities, the international vocation of top managers and the search for synergies and scope economies derived from joint administration of diverse resources owned by the company. (Galan, Gonzalez-Benito, 2001)

According to the study, other ownership factors with lower determinant power are the human potential, the establishment of agreements with foreign companies, the availability of government grants or trade agreements between countries and the existence of a prosperous financial structure.

2. Location Factors (Where to Undertake FDI?)

For location factors, the company analyzes the capabilities of the foreign market (country), such as the market size, the growth capability, infrastructure, labor cost and quality, government structure (stability of the government), stability of the economy and the competitiveness of the market…

> As regards to the selection of a location for FDI initiatives, two levels: the size of the market and its potential for growth. A third factor, the degree of competence in such a market, is also quite relevant. Thus, factors related to the opportunities of foreign markets dominate the location decision. Some classical factors, such as labor and transportation costs, which are frequently referred to in location interconnected factors stand out from others in determination and relevance theory, appear with a certain degree of relevance on a second level. Some other factors that might be included in this secondary level are related to infrastructure, industrial concentration, availability of work force, political stability and cultural affinity. (Galan, Gonzalez-Benito, 2001).

B. BENEFITS OF FDI TO THE HOST COUNTRY

Benefits that can be derived from intensive FDI flows to a host country are many. Realizing these benefits, many countries make fundamental changes in their economic policies. According to a UNCTAD (United Nations Conference on Trade and Development) report in 1998, of the total policy changes implemented in developing economies during 1991-1997, 94 per cent were designed to create more attractive conditions for FDI.

> Developing countries expect that TNCs (Transnational Corporations) can enhance a country's capital inflows, strengthen its technological base, boost its export competitiveness and raise the quantity of employment. Many countries are thus now competing with one another to attract FDI.
> (UNCTAD World Investment Report, 1999)

One can argue that FDI has both positive and negative effects, but there are many studies and strong evidence that show foreign investors affect the economic life of host countries positively. One of these studies was done by the McKinsey Global Institute (MGI), and the results were presented by Farrell (2004). MGI studied the impact of FDI on 14 local industries (automotive, banking, electronics, food retailing, etc.) in four countries (China, Brazil, India and Mexico). They looked at the changes in industry dynamics, productivity, output, and prices before and after foreign players entered the market. “The research shows that FDI is indeed good for the economic health of developing countries—regardless of the policy regime, industry, or time period studied. In thirteen out of fourteen case studies, FDI improved productivity and output in the sector, raising national income while lowering prices and improving quality and selection for customers” (Farrell, 2004).

Another study by Marcelo Soto at the OECD Development Centre explored the growth effect of various categories of foreign capital flows in a sample of 44 developing countries over the period 1986-1997. The study shows that FDI, with a lag of one year, significantly boosts per capita income growth in the host economy. According to the results of the study, a 10% rise in the FDI-GNP ratio would increase the long-run steady-state income level by 3% and short-term per capita income by 1% (Reisen, 2001).

Some other studies that analyzed the link between FDI and economic growth in the host country are Borensztein (1998), Zhang (1999) and Gruben and McLeod (1998). According to Borensztein’s study (data from 69 developing countries from the period of 1970-1989), FDI flows have a positive impact on economic growth. Zhang studied East-Asian countries, and his study shows that FDI inflows helped increase economic growth in these countries. Gruben and McLeod showed that in a sample of 18 countries, FDI had significant impact on economic growth, especially in Latin American countries (Dutz, Us, Yilmaz, 2003).

C. FDI AND ECONOMIC GROWTH

FDI contributes to the economic growth of the host country through several channels. It has both direct and indirect impacts on growth. It directly affects growth through being a source of capital formation and through net additions to the capital stock

of an economy, including the creation of factories, facilities, new machinery and infrastructure. One can safely say that an increase in FDI will contribute to an increase in total investment. And increase in investment directly contributes to economic growth. FDI also contributes to growth indirectly. FDI beneficially influences other macroeconomic variables, such as employment, exports, consumption and savings. These, in turn, enhance growth (ASEAN Economic Bulletin, 2000).

Because FDI involves significant ownership control as well as the transfer of technology, its impact on economic growth will take place through increased productivity, human capital accumulation, R&D activity and technological and productivity spillovers. In addition, its impacts on economic growth can be greater if the types of FDI that the country receives stimulate domestic investment activity (Dutz, Us & Yilmaz, 2003).

Impacts of FDI to the host countries can be grouped as follows:

- Employment Generation
- Expansion of Productivity and Output
- Transfers of Technology, Know-How and Fixed Assets
- Access to International Markets
- Upgrading Managerial and Labor Skills
- Bringing (Improving) Competition
- Other "Quality of Life" Effects

1. Employment Generation

The beneficial employment effect claimed for FDI is that it brings jobs to a host country that would otherwise not be created there. Employment effects are both direct and indirect. Direct effects arise when a foreign MNE employs a number of host-country citizens. Indirect effects arise when jobs are created in local suppliers as a result of the investment and when jobs are created because of increased local spending by employees of the MNE. The indirect employment effects are often as large as, if not larger than, the

direct effects. Toyota's investment in France created 2,000 direct jobs and perhaps another 2,000 jobs in support industries (Hill, 2003).

Extrapolation from various sources suggests a possible direct employment effect from FDI in developing countries of around 26 million jobs in 1997. Estimates of the indirect employment effect from FDI vary widely around a multiplier of 1.6 (i.e., 1.6 indirect jobs for every one direct job created). Also, MNCs do generally pay higher wages than domestic companies, and even in low-wage, labor-intensive industries, MNC jobs are often considered better than the alternatives of unemployment or underemployment. However, investments in different industries clearly have different job-creation propensities, which policymakers need to take into consideration (Aaron).

2. Expansion of Productivity and Output

FDI companies have higher labor productivity relative to local enterprises. Thus, MNCs increase the productivity in the host country. According to Caves (1974) there is a positive and strong correlation between industry average value-added per worker and the share of industry employment in foreign companies.

> In 1991, the average labor productivity in FDI companies in Turkey was 35% higher than average labor productivity in all manufacturing plants in Turkey. Between 1991 and 1996 the productivity gap between FDI companies and the sector average was narrowed down to 30% by 1996. The average labor productivity (the total quantity of output divided by the amount of labor used in production) in foreign-owned plants increased from 4.2 million TLs (Turkish Lira) (US$1,611) to 4.7 million TLs (US$1803) in 1990 prices. The average labor productivity in all plants increased from 3.1 to 3.3 million TLs (from US$1,189 to US$1,420). In sectors with a greater FDI involvement, domestic plants tend to have higher labor productivity compared to others where FDI involvement is low. All else being equal, as the share of plants with foreign participation increased by 1%, the labor productivity of all plants in the same sector increased by 0.576 million 1990 TLs (US$220) between 1991 and 1996 (Dutz, Us&Yilmaz, 2003).

3. Transfers of Technology, Know-how and Fixed Assets

Technology transfer is a key benefit of FDI in developing countries. Because FDI allows some type of control of the technology or knowledge transferred from technological leaders to followers, it is expected to be a major vehicle for technological change in host countries (Mello, 1997).

Technology effects emerge especially when liberalization of investment flows drives a more rapid rate of technology development, diffusion and transfer. Such processes may involve the transfer of physical goods and/or the transfer of tactic knowledge (UNCTAD, 1999). Evidence provided by the vast majority of economic studies dealing with the relationship between FDI, on the one hand, and productivity and/or economic growth, on the other, has found that technology transfer via FDI has contributed positively to productivity and economic growth in host countries (OECD, 1991).

When FDI flows into a host country, there is a significantly high potential for FDI to act as a vehicle through which new ideas, technologies and best working practices can be transferred to domestic firms. When an MNC decides to produce in a foreign country, it brings its own production technology, know-how and other assets (e.g., machinery) to the host country. The MNC might have production technology and equipment which is not available or not known in the host country. The domestic firms can benefit by imitating and implementing these new technologies. For example, a developing country might have huge reserves of oil but not the technology to extract and refine it. So this country may decide to invite foreign oil companies, which do have the technology. In the long run domestic companies can learn this new technology and know-how, and invest in the oil extracting and refining business. This is true also for other heavy industries, such as automotive, computer and aviation.

4. Access to International Markets

FDI also strengthens the capability of a host country to reach international markets through its international links. Many MNCs use global trading and distribution channels established by parent firms to produce capital goods and intermediate inputs,

and to export their products. There is also evidence that foreign affiliates in developing countries often demonstrate a high propensity to export, and tend to be more export orientated relative to domestic firms. This is because one motivation for investing in developing countries is to enhance multinational firms' export competitiveness through the use of cheaper labor and material inputs. By frequently engaging in trade, firms in host economies, especially the suppliers, gain access to these complex marketing networks. This, in return, can create market opportunities for other firms in the host country. Inter-firm linkages through subcontracting networks increase domestic firm's access to international markets. This applies especially to suppliers of parts and components, and of producer services. Thus, even firms who are not members of an MNC system in the first place can gain advantages in accessing international markets (ASEAN Economic Bulletin, 2000).

5. Upgrading Managerial and Labor Skills

FDI has also important contributions to the quality of human capital in the host country.

> FDI is believed to be a very important source of human capital augmentation and technological change in developing economies, since it promotes the use of more advanced technologies by domestic firms and provides specific productivity-increasing labor training and skill acquisition… Through knowledge transfers, FDI is expected to augment the existing stock of knowledge in the recipient economy through labor training and skill acquisition and diffusion, on the other hand, and through the introduction of alternative management practices and organizational arrangements, on the other… (Mello, 1997).

Since MNCs bring new organizational and managerial ideas, technology, know-how and products, the local workers and managers hired by an MNC will acquire these new skills and become more efficient and productive. MNCs also offer training to introduce these new ideas and technologies. Thus the quality of the work force in the host country will increase.

Beneficial spin-off effects arise when local personnel who are trained to occupy managerial, financial and technical posts in the subsidiary of a foreign MNE leave the firm and help to establish indigenous firms. Similar benefits may arise if the superior

management skills of a foreign MNE stimulate local suppliers, distributors, and competitors to improve their own management skills (Hill, 2003).

Also, in the long run other domestic companies can hire these trained workers and managers (with knowledge of better technologies) and benefit from their improved skills. Domestic firms can also gain these benefits by doing business with MNCs. By subcontracting with local suppliers, MNCs will transfer new managerial skills.

6. Bringing (Improving) Competition

According to economic theory, an adequate level of competition is one of the key components of a healthy market. When the competition increases in a market, not only do prices go down but also the quality of, and the extent of consumer choice for, the goods go up. Also efficiency and productivity in the industry will increase due to the high competition. Since MNCs are more productive and produce at lower costs through economies of scale and with high quality, domestic firms will have to increase their productivity and quality to survive and compete with MNCs.

7. Other "Quality of Life" Effects

Although some less efficient domestic firms may have to shut down due to high competition, consumers in the host country will benefit from higher quality, increased choices and lower prices. According to the McKinsey study, prices to consumers declined in seven out of ten cases, and product selection increased in all cases. The impact on prices was very large in some cases. For example, Chinese consumers saw passenger car prices drop by more than 30% between 1995 and 2001 (Farrell, 2004).

Democratization is considered to be another effect of FDI in the host countries. Closed-economy countries have started to liberalize their economy through market reforms that are favorable to foreign investors (e.g., privatization, property rights), particularly in Eastern Europe and former Russian republics. Economic policy in the new democracies is now subject to oversight by parliamentarians and civil society, and this may encourage a more stable policy environment for investors. Oversight may encourage a more development-focused allocation of public spending, particularly public investment

for creating skills and public goods. As a result, democratic oversight may stimulate legal reforms that protect the property rights of all (Addison & Heshmati, 2003).

Due to these exclusive advantages of FDI, many countries compete with one another in attracting foreign investors and MNCs by offering generous and significant incentive packages, investing heavily in IT and other infrastructure, and implementing fundamental liberalization policies.

D. DETERMINANTS OF FDI FLOWS INTO A HOST COUNTRY

Determinants of FDI location have been a very important and one of the most-studied research topics for academics, MNCs and host countries competing to attract more FDI flows into their economies. "Studying location determinants of FDI is obviously of interest because many developing countries view FDI as an engine of economic growth" (UNCTAD, 1992).

After having made the decision for internationalization, MNCs need to decide where to locate their operations. There are many factors affecting this second phase of the decision-making process. These factors are mainly the characteristics of the host country, such as the political and economic environments, market size, infrastructure, labor costs and quality, and availability and costs of resources. According to research by Galan and Gonzalez-Benito (2001), two interconnected factors stand out from the others in determination and relevance levels: the size of the host market, and its potential for growth. Galan and Gonzalez-Benito surveyed 103 Spanish MNCs to find out the determinant factors that affected the decision-making process of these MNCs. Table 1 shows some of the factors and the scores each factor received from the survey.

Location Factors	Relevance[a]	Adequacy[b]
Low labor costs	3.59	65.0
Low transportation/logistics costs	3.09	65.0
Labor quality	4.39	77.7
Availability and low cost of land	2.62	57.3
Large size of host market	7.13	90.3
Potential growth of host market	7.53	88.3
Low level of competition in host markets	5.57	86.4
Good infrastructure	4.21	71.8
Availability of industrial networks	3.36	70.9
Political stability	4.93	78.6
Tax reduction incentives	2.85	61.2
International trade agreements	3.01	61.2

Table 1. Measures of relevance and adequacy for location factors (After Galan & Gonzalez-Benito, 2001)

Notes: [a] Average score given to the factor (based on 10). [b] Percentage of firms that scored the factor as a determinant.

As seen in the table, the level of competition is also an important determinant. The more intense the competition, the less attractive the market. Thus, factors related to the opportunities of foreign markets dominate the location decision. Some other factors, such as labor and transportation costs, infrastructure, political stability, and quality of labor, appear with a certain degree of relevance on a second level (Galan & Gonzalez-Benito, 2001).

In a widely cited paper, Wheeler and Mody (1992) examine outward foreign investments by U.S. MNCs. They find that U.S. outward FDI is higher in countries with larger markets, a larger stock of initial FDI, higher quality of infrastructure, and more industrialized economies… The authors interpret the correlation between current and past FDI to indicate that MNCs are attracted to locations with a larger concentration of industrial firms (Hanson, 2001).

The institutional features of the recipient economy are also important determinants of FDI, including the degree of political stability and government intervention in the economy; the existence of property rights legislation determining the legal rights of foreign firms and limitations on foreign ownership; the property and profit

tax system; and the extent and severity of bureaucratic procedures. International agreements on trade and investment also influence the volume and patterns of FDI. In addition, economic factors affect the attractiveness of a country to FDI sources, such as trade and investment regime, the "openness" of the host country, and the adequacy of basic infrastructure (Mello, 1997).

The importance and effects of these factors may vary according to the MNC's characteristics. For example, manufacturing companies usually emphasize lower production costs, whereas service companies emphasize labor quality. Size of the MNC also may affect the importance of location factors. According to a survey conducted by MIGA (Multilateral Investment Guarantee Agency) in 2002, larger companies are less likely to identify labor relations and unionization as critical location factors, and more likely to focus on labor costs. They are also more likely than smaller companies to select national taxes as a key factor. Smaller companies more often select the ability to hire skilled labor, technical professionals and management staff as very important issues. They are also more likely than larger companies to be concerned with the availability of fully serviced land, as well as the reliability and quality of the overall infrastructure.

After an intensive literature research, we decided to present the factors that affect the attractiveness of a host country to the FDI as follows.

- Market size and the growth potential of the host country
- Costs and quality of the labor force in the host country
- Political and economic stability
- Business-friendly customs service
- Openness of the economy
- Infrastructure
    - Transportation
    - Communication and energy
    - Network including airports, seaport and rail system

- Incentives
- Geographic location
- Availability and cost of land, and expansion capabilities

1. Market Size and the Potential for Growth

Market size and the potential for growth is one of the most important factors, especially for market-seeking MNCs. The market-oriented MNCs are essentially motivated by gaining access to local markets; thus the size of local markets is expected to be a critical determinant because the larger market size offers greater opportunities to realize effectively economies of scale (Zhang, 2001). "The size of the domestic market, in conjunction with the growth prospects of the host country, plays a significant role when foreign investors decide to relocate production, or to engage in export-bound production in the host country" (Mello, 1997). For example, one of the fundamental reasons for China's success in attracting intensive amounts of FDI during recent decades is its huge size and enormous population.

An FDI decision is a long-term commitment for an MNC. When MNCs invest in a country, they not only investigate the current characteristics but also the future opportunities inherent in the host countries. Thus, potential for growth is also an important factor for FDI.

> In the recent past, one of the most attractive choices of location for FDI has been emerging markets. In these markets, the economic growth rate has been phenomenal, regulations have been drastically reduced, and governments have offered the right incentives to attract investments. This has resulted in the transferring of whole businesses or parts of businesses to these markets. (Choi, 1999)

2. Costs and Quality of the Labor Force in the Host Country

The labor cost is an essential part of the overall production costs. Especially for the labor-intensive manufacturing industries, low labor cost is a fundamental requirement. MNCs choose to operate in foreign countries where the labor cost is lower than in the home country. China, Malaysia and Thailand are examples of countries that are attractive due to their relatively low labor cost.

Lower labor costs are not enough in cases without a higher quality of labor force. Labor force has to be sufficiently well educated, and has to satisfy minimal quality standards. The human capital stock in the host country is a prerequisite for production relocation across country borders. International production only takes place when the basic skills needed for production with a minimum level of efficiency are present and further training is possible, such that foreign investors can use domestic non-reproducible inputs and labor of the quality needed to set up operations in the host country and sustain productive activities thereafter (Mello, 1997). Plant location decisions that ignore skill levels of the local labor force could significantly affect the ability of the MNCs to implement new process technologies, or limit the effectiveness of total quality management programs (Bhatnagar et al., 2003).

3. Political and Economic Stability

Host country's political and economic regimes play an important role in the ability of a host country to attract FDI. FDI does not come without pre-conditions, nor can host countries reap all the benefits of FDI automatically… National governments have an important task to create an enabling business environment for FDI to enter and play its catalyst role in the host countries' economic development. First of all, political and macroeconomic stability is an absolute pre-requisite for inward FDI (Sun, 2002).

"Numerous studies have amply demonstrated that political and economic stabilities, along with prospect of growth, are the most important determinants of FDI. Only in extreme cases, such as the existence of crucial natural resources, would foreign investors go to a war zone or where there is rampant inflation" (Sun, 2002).

MNCs take important risks (security of the staff, war and civil disturbance, currency inconvertibility, government refusal or inability to enforce laws, etc.) by investing in foreign countries. Thus, to minimize these risks, MNCs prefer locations with stable political/social and economic environment. Government policies concerning foreign investment, such as tax regimes, trade regimes, customs services, bureaucratic constraints and competition regulations affect the flows of FDI into the host country. Evidence from Turkey confirms this statement. Only after implementing new regulations in 1980s which liberalized and created an export-oriented trade regime did FDI flows into Turkey increase significantly.

The degree of institutionalization of its government is also a critical factor affecting the attractiveness of a host country to FDI inflows. Figure 5 shows the relationship between FDI inflows and the level of institutionalization of host country governments. According to the graph in Figure 5, as the institutionalization level of a host country government increases, FDI inflows to this country increase as well. The R^2 is 0.4492 for the correlation between the amount of FDI inflows and quality of institutional governance. This means that, nearly 45% of a variance in the amount of FDI inflows to that country can be explained by solely the quality of institutional governance.

The economic environment in the recipient country is also a critical factor that affects the location-selection process of an MNC. For example, high levels of informal economy, inflation, interest rates and corruption have a significantly negative effect on inward FDI flows. Informal economy and corruption lead to a business environment that lacks adequate competition. Higher inflation rates increase the user's cost of capital in the host economy and affect the profitability of FDI negatively, thus acting as a FDI deterrent. Higher exchange rates are also expected to affect a firm's cash flows and decrease the profitability and the attractiveness of domestic assets to foreign investors (Mello, 1997).

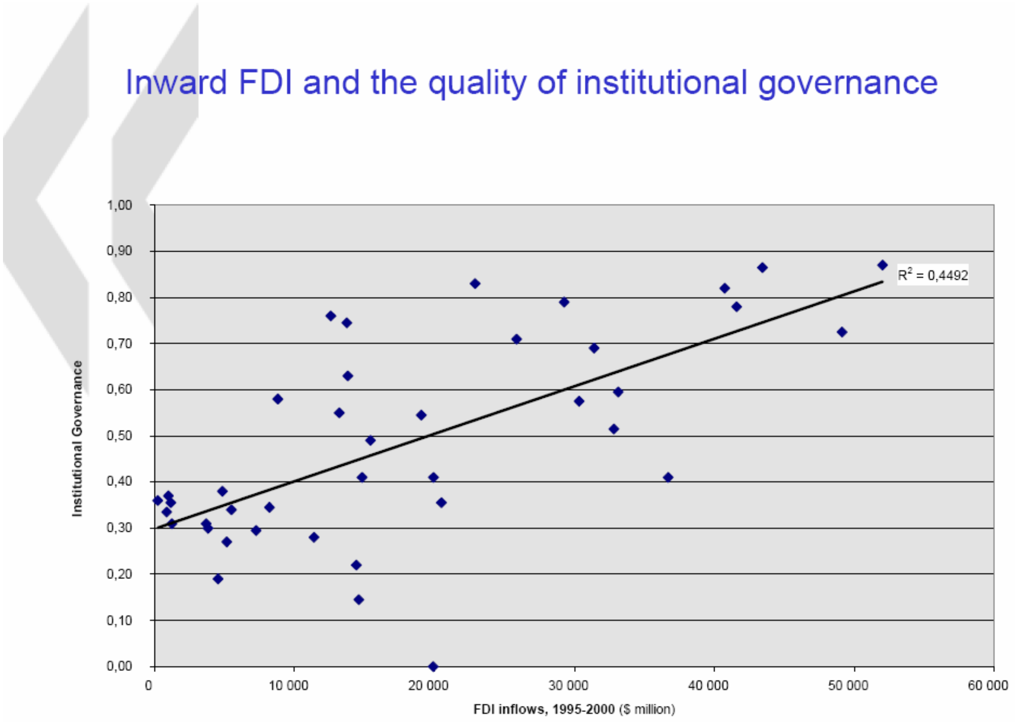

Figure 5. Inward FDI and the quality of institutional governance (From Christiansen, 2002).

4. Business Friendly Customs Service

Any manufacturing facility must have an access to world-class sources of raw materials and components. Certainly, many inputs will be available locally in quantities and quality needed to support such manufacturing. However, no single market, whether developed or emerging, can produce all of the world-class inputs needed for complex manufacturing operations. Therefore, global corporations are creating sophisticated international supply-chain management systems to move goods quickly and economically around the world. However, lack of efficient and modernized customs services will cause delays in these sophisticated supply chains (ICC policy statement, 1999).

The International Chamber of Commerce (ICC), a world business organization, urges governments to recognize that modernization of customs administrations is an important catalyst to attract FDI. As tariff and other trade barriers are reduced or eliminated through global and regional trade negotiations, customs modernization becomes more and more important to each country’s interest in attracting foreign direct investment. As tariff barriers fall, multinational and other companies look increasingly to

the existence of business friendly policies in deciding where to invest. Countries that fail to keep pace with the world-class standards for customs administration will find that investors simply cannot afford the high logistics costs imposed by customs inefficiencies. Finance ministers in these countries will find FDI migrating to nations with more sophisticated customs administrations.

According to an ICC policy statement released in 1999, there are three critical aspects of customs services that affect the attractiveness of a host country:

Clearance time - To support world-class manufacturing, customs clearance time must be measured not in weeks, or even days, but in hours. Any customs administration that can provide reliable, timely customs clearance, or immediate release based on pre-clearance, creates an enormous competitive advantage in attracting manufacturing.

Predictability - Delayed delivery of a key input can shut down an entire manufacturing line, at enormous cost. Unpredictable delivery due to customs administration can require the maintenance of excessively large "safety stock," with unacceptable inventory carrying costs. Arbitrary or unpredictable customs clearance delays are incompatible with efficient manufacturing.

Transparency - Arbitrary or unexplained changes in classification or valuation of goods can disrupt logistical flows and marketing plans, thereby seriously detracting from efficient operation.

Having customs agreements with other countries with large market sizes is another important advantage for a host country. By having this, a country can serve as a base for manufacturing and exporting goods to these large markets. The Toyota investment in Turkey is a good example; after Turkey signed a customs agreement with the EU (European Union), Toyota increased its investments in Turkey.

5. Openness of the Economy

The liberalization of a country's foreign economic transactions is expected to affect the level of FDI inflows to that country. A country's foreign trade (total exports plus total imports) as a portion of its GDP is the measure of how open a country is to international markets. Openness of economy can be also defined as willingness to allow

foreign participation in domestic markets and ability to compete in foreign markets. Foreign trade and FDI are complimentary. Some host countries try to prevent the establishment of import-oriented MNCs to protect their own domestic industry, and they implement regulations that favor FDI inflows that are mostly export-oriented. Since openness is the total of imports and exports, this policy—focusing only on exports—seems ineffective.

There is a strong and positive correlation between FDI (inflows and outflows) and openness of the host country economy. Figure 6 shows the relationship between openness of the host country economy and FDI. According to the graph in Figure 6, the higher the openness of economy, the higher the ratio of both FDI inflows and outflows to GDP is. For example, Netherlands has a relatively high openness level at 45%. Due to its highly open economy, the ratio of Netherlands' average inward and outward FDI flows to its GDP is considerably high.

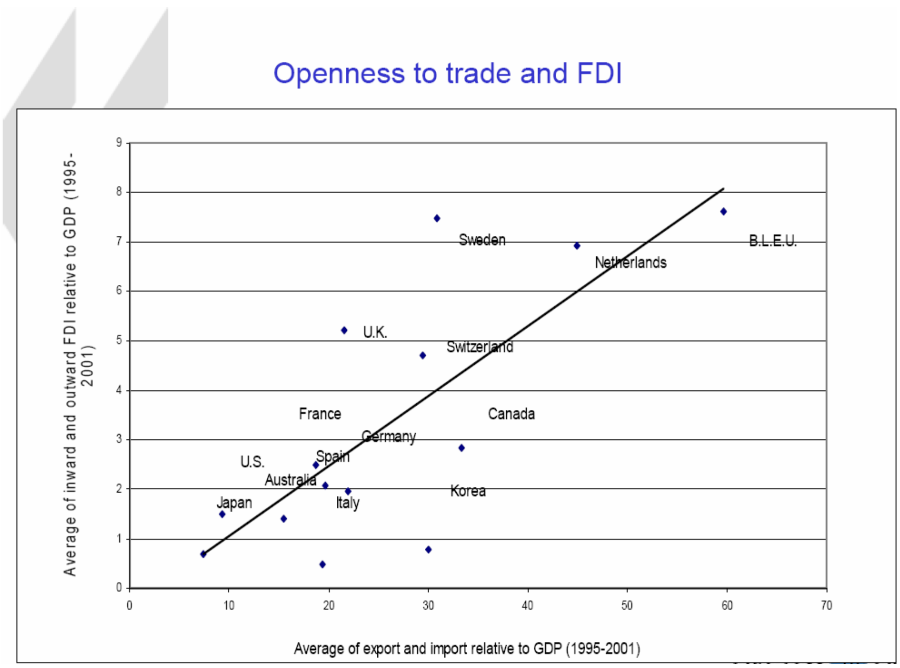

Figure 6. Openness of the economy and FDI inflows (From Christiansen, 2002).

6. Infrastructure

Presence of high quality physical and technological infrastructure in the host country is another important pre-requisite in order to create an enabling business environment for MNCs. The absence of adequate supporting infrastructure (e.g., telecommunications, transportation, power supply) discourages foreign investment because it increases transaction costs. Foreign investors prefer countries with good infrastructure, which will facilitate communication, transportation and distribution (Tatoglu & Erdal, 2002).

a. Transportation

Transportation is one of the most important aspects of the supply chain for MNCs. The quality and the number of roads and other transportation modes influence the attractiveness for FDI. Availability of intermodal connections between roads, railways and air and sea transportation gives a significant advantage to a host country trying to attract foreign investors.

b. Communication and Energy Infrastructure

To become a business hub for MNCs, a host country also must have a high-quality communication network. Availability of cheap and improved internet services, wireless connection and communication networks and state-of-the-art IT infrastructure is one of the critical requirements to facilitate the exchange and dissemination of reliable information for foreign investors. A reliable and improved energy network is also crucial, especially for manufacturing-based MNCs.

c. Airports and Seaports

Availability of modern and well-designed airports and seaports is an essential requirement, as are easy connections between them. Airports must be designed effectively to handle connections, arrivals and departures; must have sufficient capacity and an adequate number of runways to handle passenger and cargo traffic. Security has become more and more important after 9/11. Airports and seaports must have the most recent, high-tech security systems. Delays caused by inefficient security in these facilities will increase logistics costs, and might cause stops in production lines. This is a deterrent

for FDI and will cause MNCs to relocate their operations to other foreign countries in the region.

7. Incentives

Although the effectiveness of incentives given to foreign investors is arguable (Farrell, 2004), many countries around the world have been offering tax holidays, import duty exemptions, and subsidized land and power to lower the cost of investment for MNCs and attract more FDI into their countries.

> Policies to promote FDI take a variety of forms. The most common are partial or complete exemptions from corporate taxes and import duties. These policies are typically the result of formal legislation or presidential decree, which apply to all foreign corporations (MNCs) that meet certain restrictions. These restrictions vary considerably across countries. In many cases they require MNCs to establish production facilities in the host country in specified lines of activities or designated regions (Hanson, 2001).

Direct subsidies are another common way that host countries offer incentives, but these are usually negotiated between governments and MNCs on a case-by-case basis. GM's (General Motors) and Ford's investments in Brazil can be seen as the results of generous subsidies offered by the Brazilian government to these companies individually. For instance, Brazil gives generous tax incentives to firms that locate manufacturing facilities in the Amazon region. Unspecified government subsidies appeared to be important in luring Multibras (a U.S.-owned firm) to construct a $400 million plant to produce air conditioners and ovens in Manaus in 1998. Investment subsidies also appeared to be important in convincing Honda to build a motorcycle plant in the area. In the absence of tax breaks, there appears to be little reason why MNCs would locate in the region (Hanson, 2001).

8. Geographic Location

Geographic location has different aspects: geographic centrality, being at the crossroads between regions or continents, and proximity to large markets and natural resources. Turkey being at the crossroads between Europe and Asia, Singapore and Hong Kong, and being close to the huge Chinese market, give Turkey significant advantages considering just its geographic location. Having coastal access is also another advantage.

9. Availability and Cost of Land, and Expansion Capabilities

To construct production and distribution facilities, availability of cheap land is required for attracting MNCs to a host country. Once they have established their initial structures, MNCs then try to expand their operations and facilities in the host country. Thus, availability of extra land for expansion is also an essential strategic decision factor for MNCs during the location-selection process. For example, the United States, India, China and Turkey have significant advantages considering the availability of cheap land, whereas Singapore suffers from a lack of land for expansion.

These are the basic requirements for a host country to attract foreign investors. Different MNCs might focus on different factors while determining their investment locations. For example, the lack of stability in the host country government might be a critical deterrent for one MNC, whereas another MNC would prefer to locate its operations in the same host country due to the availability of vast and unique natural resources. One MNC might prefer a country with a large market, where another one would prefer one with lower labor costs but no large market. However, countries must focus on all of the requirements presented above to attract more MNCs and more FDI inflows into their economies.

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III. METHODOLOGY AND ANALYSIS

A. METHODOLOGY

To analyze Istanbul, we have studied two approaches: First, a "Value Net" analysis to uncover Istanbul's position in attracting FDI, and second, a SWOT (Strengths-Weaknesses-Opportunities-Threats) analysis to examine Istanbul's capabilities as it aspires to become a regional business hub.

Brandenburger and Nalebuff, academics from the Harvard Business School and the Yale School of Management, respectively, introduce the term "Co-Opetition" and suggest that business strategy in today's global environment must combine competition and cooperation. They consider any business as a *game* that has four players. To explore the roles of all four types of players—customers, suppliers, competitors, and complementors—Brandenburger and Nalebuff construct a map, which they call the Value Net, representing all the players and the interdependencies among them.

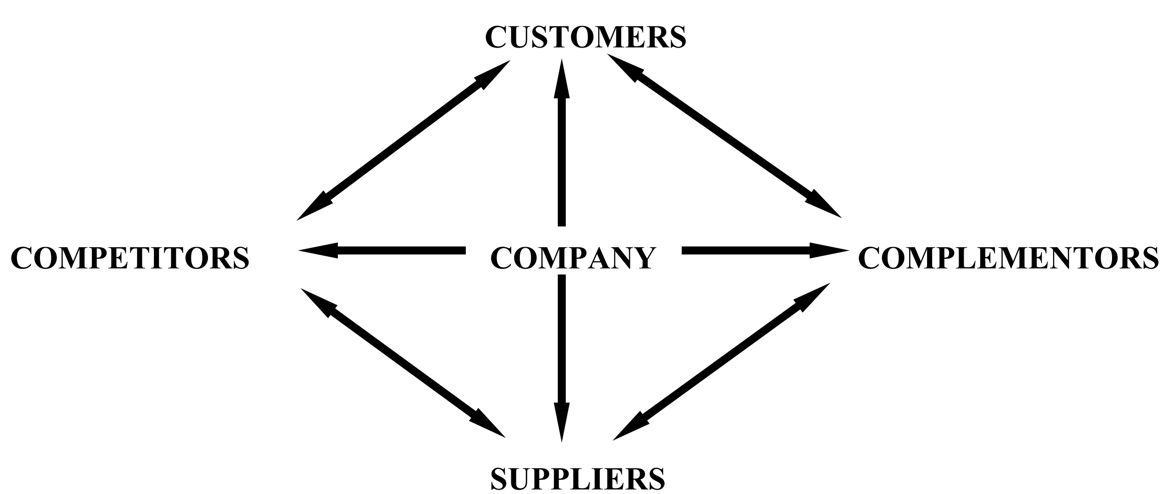

Figure 7. Value Net (From Co-Opetition, 1996)

"Along the vertical dimension of the Value Net are the company's *customers* and *suppliers*. Resources such as raw materials and labor flow from the suppliers to the company, and products and services flow from the company to its customers. Money flows in the reverse direction, from customers to the company and from the company to suppliers. Along the horizontal dimension are the company's *competitors* and

complementors (Brandenburger and Nalebuff, 1996)." Brandenburger and Nalebuff defined the *complementor* and *competitor* as follows:

A player is your complementor if customers value your product* *more* when they have the other player's product than when they have your product alone.

A player is your competitor if customers value your product *less* when they have the other player's product than when they have your product alone.

*Product is used to cover both products and services.

According to the authors, the Value Net approach applies to any organization—private, public or nonprofit. For the purpose of this analysis, we regard the city of Istanbul as a business identity. We look at the situation from the eyes of the local government, The Municipality of Metropolitan Istanbul (MMI), which has the key role in planning and executing most of the aspects that we discuss. This way, we put Istanbul in the middle of the map and we substitute raw materials with infrastructure as a resource.

The second part consists of a SWOT analysis. The SWOT analysis is a useful tool for decision-makers to understand all sorts of situations in business and organizations. It is used to develop a plan that takes into consideration many different internal and external factors, and maximizes the potential of strengths and opportunities while minimizing the impact of weaknesses and threats.

The SWOT analysis template is normally presented as a grid, comprising four sections, one for each of the SWOT headings: Strengths, Weaknesses, Opportunities and Threats. While Strengths and Weaknesses represent the internal factors, Opportunities, and Threats represent the external factors.

	POSITIVE	**NEGATIVE**
INTERNAL	Strengths	Weaknesses
EXTERNAL	Opportunities	Threats

Figure 8. The SWOT Matrix

To carry out a SWOT Analysis, it is useful to write down answers to the following sample questions in every element (http://www.mindtools.com, date accessed 11/19/2004).

Strengths:

What advantages do you have?

What do you do well?

What relevant resources do you have access to?

What do other people see as your strengths?

In looking at their strengths, businesses should think about them in relation to their competitors—if all the competitors have or do the same thing, then it is not strength, it is a necessity.

Weaknesses:

What could you improve?

What do you do badly?

What should you avoid?

Opportunities:

Where are the good opportunities facing you?

What are the interesting trends you are aware of?

Threats:

What obstacles do you face?

What are your competitors doing?

Are the required specifications for your products or services changing?

Could any of your weaknesses seriously threaten your business?

SWOT analysis is a very common framework that helps businesses to focus on their strengths, minimize weaknesses, and take the greatest possible advantage of opportunities available while avoiding possible threats.

B. ANALYSIS

Turkey is the largest economy in Eastern Europe, the Balkans, the Black Sea basin, and the Middle East. Although it is the European Union's sixth biggest trading partner, FDI flows into Turkey have rarely reached one billion USD in any one year—a fraction the level of FDI attracted to countries of comparable size and development like Argentina and Mexico and only one-quarter the level of FDI attracted into Poland (Öğütçü, September 2002).

The Turkish economy has been growing rapidly and transforming itself from a pre-industrial agricultural economy into an industrialized economy. Since the 1980s the growth of real income and the modernization of industrialization have been rapid. The manufacturing sector grew the most rapidly, followed by the service sector.

Turkey owes its economic growth partly to Istanbul. Istanbul is the largest city of Turkey, both in terms of its economic development and its urban population growth. The city contributes 40% of the nation's foreign trade imports and exports, and 34% of the nation's budget (Istanbul Chamber of Commerce, 1999). The 2000 census shows that Istanbul has a population of over 10 million (currently about 12 million), which represents 14.78% share of the national total.

Over the past decade, the Istanbul metropolitan area has gained importance as the core region for Europe, the Middle East, the Russian Federation and the Turkic Republics because of its strategic geographical location and increasingly intensive connections. The growth of the service sector in Istanbul since the 1980s may be attributed to the expansion of foreign multinational corporations, transnational banks, growth in international relations, extension of foreign trade and enlargement of business size.

Turkey has attracted foreign companies, especially those originating from member countries of the European Union. Istanbul continues to lead the economic life of the country, and most foreign companies have preferred to invest in Istanbul (Berköz, 1997).

Istanbul is the chief seaport as well as the commercial and financial center of Turkey. Automobile and truck assembly, shipbuilding and ship repairing, cement production, pottery, food processing, textile production, oil products, rubber, metal ware, leather, chemicals, electronics, glass, machinery, paper and paper products, tobacco and alcoholic drinks are among the various industries found in the city. Istanbul is also an important center for banking and insurance.

1. Value-Net Analysis

We first apply the Value Net analysis to understand Istanbul's position. By explaining all the players, we will expose Istanbul's position in attracting investors. This exercise is an essential input into the process of generating new strategies.

Drawing a Value Net for a city gives a better understanding of some of the issues facing many cities. We believe it will promote the debate to think about cities as businesses—with customers, suppliers, competitors and complementors, like any other business.

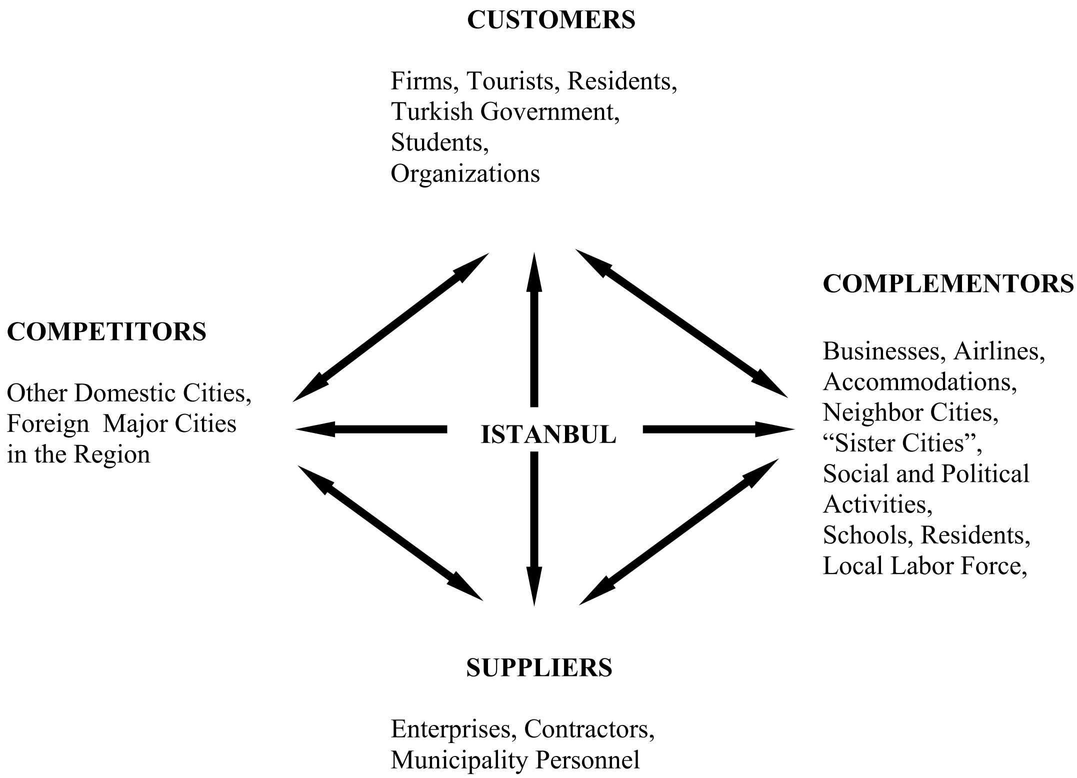

Figure 9. Istanbul's Value Net

a. Istanbul's Customers

Thinking of a city, every single taxpayer is a customer. About 12 million residents and over 412,000 companies in Istanbul are expected to pay 133 million USD for tax in 2004. In terms of the revenue, the biggest customer seems to be the central government with 57.6% share in the city's revenues. According to Figure 10, Istanbul receives the biggest share of its revenues from the central government grants. Although the central government seems to be the main customer; its contribution, in fact, is only 22% of Istanbul's own contribution to the national budget.

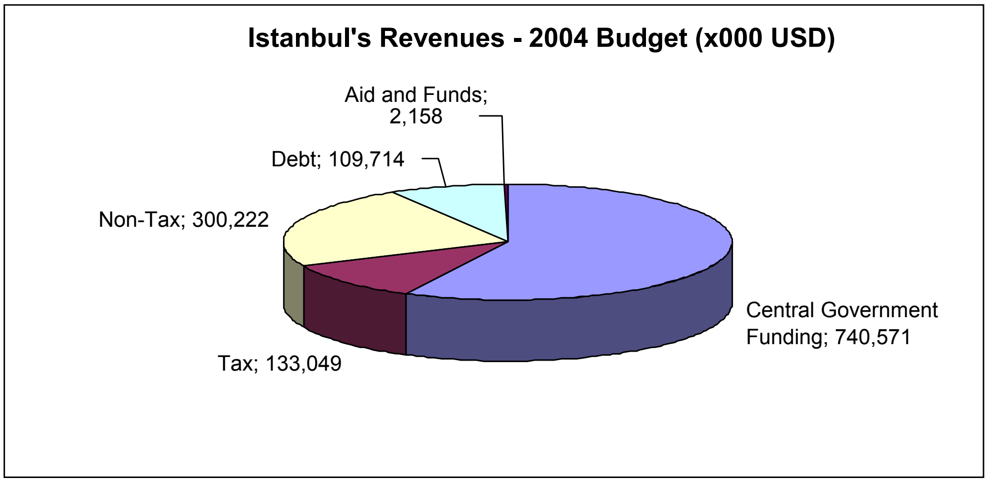

Figure 10. Istanbul's Revenues (Generated from the data from www.ibb.gov.tr date accessed 12/05/2004)

Tax revenues are vital for a city; that is why reviewing the taxpayers (customers) is essential, particularly our point of interest: multinational companies. Importantly for cities, multinational companies are economic winners with high salaries and financial investments. Tax is not the only revenue that a city gains from multinational companies. In addition, they bring managerial skills, business knowledge, new export opportunities, new jobs, and (most importantly) new technologies. In the previous chapters we explained why and how companies decide to locate in a particular geography. A city that wants to attract such investors must analyze those determinants and build its strategy focused on associated factors, as well.

Besides local taxes and central government grants, Istanbul is planning to generate revenue of 300 million USD as non-tax in 2004. This revenue comes from rents, user charges, and enterprise and service profits. In this context, everyone in the city becomes a customer, unsurprisingly. This ties us to another important customer group: tourists and students. One might consider tourists and students as "customers of customers," since their expenses are part of the revenue of companies and schools that are located in Istanbul and serve those customers. Here we consider them as direct customers, though, since they play a key role in Istanbul's strategy to become a regional hub. In 1999 Istanbul hosted more than 1.7 million tourists, with 1.3 billion USD of foreign currency gain. Apart from the monetary gain, the experiences and reviews of

these people have positive impact on other potentials and are very important for the city's reputation.

The last statement is also true for the multinational companies. Having more and more multinational companies, a city—as a whole—becomes more sophisticated about the processes and focuses more on the infrastructure. These characteristics add up to attract others and ensure the city's reputation.

b. Istanbul's Suppliers

The city's suppliers are contractors and enterprises, primarily, working for—or with—the municipality. The Municipality of Metropolitan Istanbul (MMI) provides essential services with owned enterprises and municipality institutions, and executes its projects with either affiliated companies or contractors.

Two important institutions of the MMI are ISKI and IETT. ISKI (Istanbul Water Utility) provides drinking water and sewage services, and IETT (Istanbul Bus Operator) handles transportation services (www.ibb.gov.tr date accessed 12/05/2004).

Recently electricity distribution is licensed to private enterprises for a fixed number of years on a revenue sharing basis. Private enterprises distribute electricity and maintain and upgrade the physical distribution network. BEDAS is the electricity distributor in the European side of Istanbul, where AKTAS is in the Asian side.

ISKI, the responsible firm for water operations in Istanbul, became the biggest public company in Turkey in 1995. The annual budget of ISKI in 1996 was USD 471.2 million, and its investment budget was USD 195.1 million. These investments of ISKI can be evaluated in two main groups: drinking water and wastewater. The number of staff members at ISKI is around 7,300. Duties and authorities of ISKI can be summarized as follows:

- Planning, construction, and operation of provision of water
- Planning, construction, and operation of wastewater disposal
- Protection of surface water resources such as seas, lakes and riverbanks, as well as groundwater resources, against pollution, and to make every kind of technical, administrative and judicial decision

IETT is a public institution, providing intra-city transportation facilities throughout Istanbul. 24 percent of whole intra-city passenger transportation is made by IETT in Istanbul. Again, 57 percent of the public mass transportation is carried out by IETT. The road network of IETT is 1,250 km. The length of the total line is around 6,100 km. IETT has 2,569 buses, and 2,030 of them are in service each day. The length of distance traversed by these 2,030 busses each day is 420,000 km. Approximately 10,000 people work for IETT and more than two million passengers use the IETT transportation service every day. IETT is also responsible for the management and inspection of Private Buses (ÖZ) and Double Storied Buses (www.ibb.gov.tr date accessed 12/05/2004).

Apart from these two important institutions, the MMI currently owns 19 municipal companies in various specialties. Notable companies that serve the city are introduced below (www.ibb.gov.tr date accessed 12/05/2004).

- İDO A.Ş. (Istanbul Sea Buses Corporation)

Istanbul Sea Buses Corporation was established in 1987 by the MMI in order to contribute to the sea transportation, and to the solution of traffic problems in the city. With the introduction of sea bus lines one after another, many points of Istanbul and nearby provinces can be reached now, and high speed and quality is created in sea transportation. İDO's areas of business include transportation of passengers and all sorts of cargo, providing modern services at ships, ports, terminals and their transport lines, and the supply and provision of services.

- İGDAŞ A.Ş. (Istanbul Gas Distribution Corporation)

As the exclusive natural gas distribution company in Istanbul, İGDAŞ now ranks 3rd in the natural gas sector in Europe. Established in 1986, İGDAŞ's mission is to provide the public with clean-burning natural gas and to establish and operate all infrastructure and related facilities for the utilization and purchase of natural gas.

- İSBAK A.Ş. (Istanbul Transportation Maintenance Corporation)

Established in 1986, İSBAK's mission is to produce traffic signal systems for the greater Istanbul area; to carry out traffic, planning and feasibility studies; to produce

superstructure equipment for signal and junction control devices; and to provide traffic and system engineering. İSBAK has designed, developed and manufactured a range of products in two key sectors: traffic management systems and electronic payment systems.

- İSFALT A.Ş. (Istanbul Asphalt Corporation)

Established in 1986, İSFALT's mission is to build all facilities necessary for the production of asphalt and to produce and meet the asphalt demands of the greater Istanbul metropolitan area. İSFALT not only produces asphalt, but it also operates in asphalt and surface pavement applications, road construction, infrastructure-superstructure construction works and designs and ground studies, and it provides technical consultancy and laboratory services.

- ULAŞIM A.Ş. (Istanbul Transport Corporation)

Established in 1988 with the objective of contributing to the solution of the city's traffic and environmental pollution problems, ULAŞIM's mission is to alleviate the city traffic congestion by operating rail transport systems and engaging in all transportation activities within the city. Currently ULAŞIM operates two railway systems. The company has 250 vehicles used in its rail systems. Its activities within the rail system comprise three elements: metro (underground), light metro, and tram.

Finally, we introduce the last type of supplier: personnel. Undoubtedly, the Municipality of Metropolitan Istanbul, with its affiliated companies and huge budget, is one of the biggest organizations in Turkey. It has been providing various services for around 10 million people in a huge area. That is why MMI needs huge human resources. The number of personnel serving in the Municipality of Metropolitan Istanbul and its affiliated companies is 39,484, according to January 2000 records (http//www.ibb.gov.tr date accessed 12/05/2004).

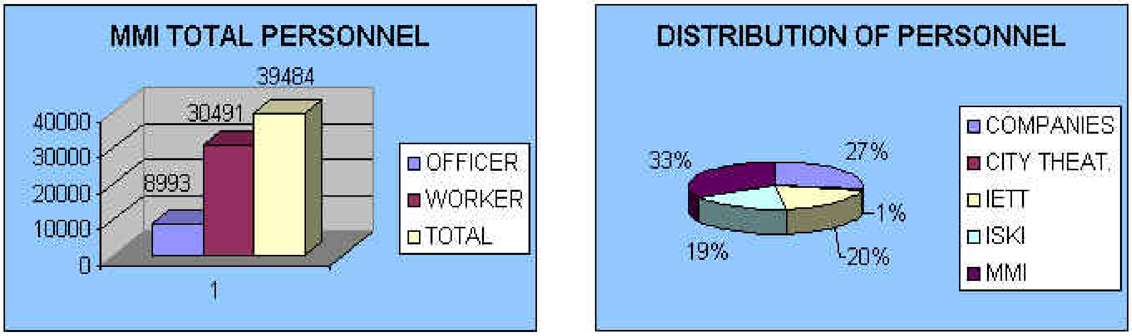

Figure 11. MMI Total Personnel (From www.ibb.gov.tr date accessed 12/05/2004).

c. *Istanbul's Competitors*

According to Webster and Muller (2000), urban competitiveness refers to the ability of an urban region to produce and market a set of products (goods and services) that represent good value (not necessarily lowest price) in relation to comparable products of other urban regions. Urban regions are becoming more exposed to global forces, as the nation-state becomes more open to capital and trade flows. This represents an opportunity in which cities now have more scope to develop their own competitiveness strategies and access world markets, global labor and capital.

The main purpose of this Value Net analysis is to examine the city's competitive position. Yet, assessing Istanbul's regional competitiveness requires other studies that use specific methodologies to assist long-term strategies. This part of the study presents only a limited comparison to selected foreign competing cities in various important characteristics that affect competitive advantage.

A city competes with other domestic or foreign cities in the same region with regard to both customers and suppliers. It aims to attract more businesses and tourists than others while it tries to employ more skilled personnel. Since Istanbul is very dominant in the borders of Turkey (although Ankara is the official capital, Istanbul has always been the center of the country's economic life, due to its location at an international junction of land and sea trading routes), as stated above, we are going to focus on foreign competitor cities.

For an urban region, there are four assessment categories in undertaking competitiveness assessment, which are interrelated: Economic Structure, Territorial

Endowments, Human Resources, and Institutional Milieu (Webster and Muller, 2000). We are going to use a number of indicators from each category in our comparison.

Survey studies show that MNCs that are doing business in Eastern Europe are more likely attracted by Czech Republic, Poland and Hungary than by Turkey (Loewendahl & Ertugal-Loewendahl, 2001). This has led us to choose Prague, Warsaw and Budapest as the main competitor cities to compare with Istanbul. Table 2 demonstrates the data from these four competing cities as major urban regions.

INDICATOR	ISTANBUL (TURKEY)	PRAGUE (CZECH REP.)	WARSAW (POLAND)	BUDAPEST (HUNGARY)
Area	5,220 km^2	496 km^2	512 km^2	525 km^2
Population	10 million	1.2 million	2.5 million	1.9 million
GDP (USD) (2003)	53 billion	21 billion	6.5 billion	30 billion
Unemployment Rate	10% (2004)	3.7% (2004)	18.3% (2003)	2.1% (2002)
Number of Businesses	412,000	75,000	254,000	69,000 (2001)
Intl. Airport Capacity	14 million	8-10 million	4.5 million	5.5 million
Seaport Capacity	1.6 million TEU/yr	N/A	N/A	N/A
Railway Length	114 km	244 km	110 km	292 km
Telephone Lines/1,000	280	649	498	455
No. of Internet Providers	39	26	6	21
Number of Universities	20	10	13	13
Number of Tourists/year	5 million	2.5 million	5 million	2 million
Total Room Capacity of Hotels	40,000	51,000	16,500	29,315

Table 2. Competitiveness indicators of Istanbul, Prague, Warsaw and Budapest (Data derived from www.ibb.gov.tr, www.e-warsaw.pl, www.fsz.bme.hu, and www.pis.cz date accessed 12/05/2004)

According to Table 2, Istanbul has many advantages over competitor European cities. Yet, these advantages have not provided Istanbul with desired foreign investment. We believe that this unfavorable condition is a result of both internal and external inefficiencies over which Istanbul has no, or very limited, control. We will explain these factors in the SWOT analysis.

d. Istanbul's Complementors

Cities, though they compete with one another for shared customers, are complementors in creating the market for higher quality of life in the first place. Neighbor cities help Istanbul grow in terms of expansion capability. The more the neighbor cities are developed, the more Istanbul gains from being in that region.

The list of complementors to a city includes many more. Airline companies, social and political activities, accommodations and schools complement Istanbul. They provide the backbone for the city to attract more customers (tourists, students, academicians, businesses and organizations). Istanbul has also a great advantage in terms of congress and conference tourism. The number of five-star hotels is more than 20 in the city, and they form one fourth of the total hotel capacity.

Local businesses and MNCs that are already located in a city complement to it to attract more. Currently, all of the private banks in Turkey have their headquarters in Istanbul, making the city the banking hub of Turkey. This situation, as expected, encourages any newcomers also to locate in Istanbul. It also helps the city's efforts to be an international financial hub (e.g., Switzerland, Luxembourg, and Singapore) in the region.

Sister City Relationships (SCR) also complement a city. Besides its relations with many other international organizations, Istanbul has 39 sister cities from all over the world, including its competitors in terms of FDI: Prague, Warsaw and Budapest. SCRs are based upon a commitment to develop sustainable international relationships based upon a mutual understanding between the partners. Priorities are set by each local chapter, involving a diverse range of activities, including economic cooperation, student exchanges, health care projects, cultural programs, municipal cooperation, and many more. Sister city partnerships have the potential to carry out the widest possible diversity of activities of any international program, including every type of municipal, business, professional, educational, and cultural exchange or project (MMI).

Local labor force is an important complement to cities. Istanbul has highly skilled and trained labor forces educated in the best universities and high schools of

Turkey. Half of the top 500 industrial enterprises in Turkey have their factories and business centers in Istanbul and so the city has attracted the highest percentage of qualified workers in the country.

The ultimate example of a player occupying more than one position in the Value Net is Turkish Government. It can appear in the role of customer or complementor. When the central government buys goods and services or provides funding, it is being a customer like any other. Meanwhile, it serves as a supplier to every business activity by providing civil order, laws and regulations, and a stable currency.

No doubt there is more to say about the Value Net for Istanbul. Our point is that applying this model and drawing the Value Net for a city is a valuable exercise. This analysis helps us introduce all the players in a city's development (customers, suppliers, competitors and complementors), their roles, and the relationships among them. By the Value Net, we represent all the internal and, more importantly, the external elements that have an effect on Istanbul's activities. Focusing on only one type of player or one type of relationship tends to produce blind spots. Taking in the wider picture reveals many new strategic opportunities (Brandenburger and Nalebuff, 1996).

2. SWOT Analysis

Governments all over the world have or are recognizing the strategic and economic benefits from being a business hub. In this manner, they prepare SWOT analyses to assess their competitive advantages. One of the recent studies was prepared by International Enterprise Singapore in 2002. "Developing Singapore into a Global Integrated Logistics Hub" presents the key strategies and recommendations to enhance Singapore's competitiveness as a logistics hub.

For the SWOT analysis of Istanbul, we have looked at the current capabilities of Istanbul for becoming a regional business hub. As we discussed in the previous chapters, while doing the SWOT analysis we basically analyzed what the city is good at, what it lacks, what opportunities it possesses and what current threats it faces to becoming a regional business hub. With the purpose of this analysis we referred to the location requirements for attracting foreign investors into a host country.

	POSITIVE	NEGATIVE
INTERNAL	**Strengths** - Huge Market Size - Geographic Location - Business Friendly Custom Service - Incentives - Free Trade Zones - Quality of Labor Force - Availability of Land and Expansion Capability - Tourism - Openness of the Economy - Intermodal Transportation Capability	**Weaknesses** - Lack of Political and Economic Stability - Traffic Congestion - Earthquake Risk - High Migration Rate - Low Income Level Per Capita
EXTERNAL	**Opportunities** - EU Membership - Establishment of Peace in the Middle East - Reconstruction of Iraq and Afghanistan - Relationships with Turkic Republics	**Threats** - Developing Competitor Cities in the Region - Denial of EU Membership - Terrorism in the Middle East

Table 3. SWOT Matrix for Istanbul

a. Strengths

Huge Market Size: With a population over 10 million Istanbul is a huge market itself. As the economic, cultural and industrial center of Turkey, Istanbul serves the whole of Turkey as its market. Due to its advantageous geographic location, the Balkans and Eastern Europe, Caucasia, and the Middle East can be easily served as consumer markets from the production and distribution facilities established in Istanbul. In a wider range, Istanbul has the capability to serve the whole of Europe, Russia, Central Asia and North African countries (Egypt, Libya, Tunisia and Algeria). Tatoglu and Glaister (2000), in a recent survey of 98 foreign firms, found the most important strategic motives for FDI in Turkey were to gain access to new markets and to enable faster market access. They found market size and the growth rate of the Turkish economy to be key location factors encouraging foreign investment in Turkey (Loewendahl & Ertugal-Loewendahl, 2001).

Geographic Location: Being at the crossroads of two major continents, Europe and Asia, Istanbul enjoys a very unique location connecting these two continents not only geographically but also culturally and economically (See Figure 4).

Business Friendly Customs Service: Istanbul has a very modern and business-friendly customs service. Recent improvements eased the check-in process and reduced delay times for goods to move in and out of the country. To provide better service to the trade community, ensure selective but more effective customs control and uniform implementation of customs legislation, and create an easy-to-proceed through customs service, the Prime Ministry Undersecretariat of Customs initiated the project GIBOS (Customs Automation Project) in 1988 and acquired new software in 1998, which improved the level of modernization in customs offices.

The Customs Union Agreement signed with the European Union in 1996 is expected to boost foreign investment in Istanbul. In this respect, Istanbul will attract especially MNCs from third-party countries (non-members of the Customs Union) that want to access the huge European market.

Incentives: Turkey provides a rather competitive tax system. The country also provides generous incentives in various ways, including a speedy application process. There are no conditions for approval of foreign credit acquisition or licenses, technical assistance, and managerial agreements. Another major incentive is the tax exemption. Currently, foreign investors are exempt from customs duties and funds levies, and are also exempt from Value Added Tax (VAT) on machinery and equipment, whether imported or purchased within Turkey. Investment incentives can be summarized as:

- Exemption from customs duties and fund levies
- Investment allowance
- VAT exemption for imported and locally purchased machinery and equipment
- Exemption from certain taxes, duties and fees

- Credit allocation from the budget in order to guide and encourage the investments aiming at regional development, research and development (R&D), and environmental protection.

Free Trade Zones: In 1985 Turkey issued Free Trade Zones (FTZ) legislation with the objective of increasing export-oriented investment and production. Currently five of the 21 Turkish free trade zones are in Istanbul:

- Istanbul Leather and Industry FTZ
- Istanbul Ataturk Airport FTZ
- Istanbul International Stock Exchange (ISE)
- Istanbul Thrace FTZ
- Istanbul-European FTZ

Quality of Labor Force: Turkish people are known as very hardworking people in the world. Nearly 90% of Turkish men and 80% of Turkish women work for more than 40 hours a week (Loewendahl & Ertugal-Loewendahl, 2001). Istanbul has a highly skilled and trained labor force educated in the best universities and high schools of Turkey. There are 20 universities established in Istanbul and approximately 160,000 students studying in these universities.

A survey conducted by IMD (International Institute of Management Development) in 2000 shows that Turkey has significant advantages considering the labor quality. IMD surveyed 3,263 senior managers in 47 countries, asked them to rank the countries according to a set of business-related factors The countries were ranked by the World Competitiveness Yearbook 2000 to determine how these nations can help businesses operating within their borders sustain domestic and global competitiveness. A total of 290 criteria were used to derive the ranking Table 4 is derived from this survey data, and shows the ranking and a limited comparison of Turkey with some other countries in the same region from the labor quality aspect. According to the survey, Turkey stands as the 11th country among 47 countries considering the overall quality of labor, where Hungary, Greece, Poland, and Czech Republic stand as the 13th, 26th, 27th and 35th, respectively.

	Turkey	Hungary	Greece	Poland	Czech Rep.
Labor regulations are flexible enough	11	5	32	17	19
Availability of competent senior managers	8	31	33	40	46
Management has significant international experience	12	30	28	40	46
Availability of qualified engineers	13	1	16	26	33
Availability of qualified IT employees	12	2	25	16	31
Total	56	69	134	139	175
Average ranking*	11.2	13.8	26.8	27.8	35

Table 4. Quality of Labor in Turkey (Derived from the IMD Survey, 2000.) (Ranking is made from 1 to 47 for each category, rank 1 being the best)

* Based on the rankings for the five criteria listed in the Table 3.

Availability of Land and Expansion Capability: Although the land area of Istanbul is relatively small (5,220 km^2), neighboring cities (Kocaeli 3,626 km^2 and Tekirdag 6,218 km^2) provide important expansion areas for production and distribution facilities. These two neighbor cities are both heavy industry cities and complementary to Istanbul.

Tourism: Istanbul is one of the major tourist-attracting locations not only in Turkey but also in Europe. Every year approximately 2 million tourists visit Istanbul. It owns a unique history as the only city which has been the capital of three different and great Empires: Roman (330-395), Byzantine (395-1453) and Ottoman (1453-1922). Remains from these empires all around the city are only a few of the great tourist attractions.

Openness of the Economy: As defined in previous chapters, openness of the economy of a country is measured by the ratio of its total amount of exports and imports to its GDP. Since 1980 Turkey has enacted many new regulations to liberalize its economy. As a result of these liberalization attempts, Turkish economic policy changed from a protectionist trade regime to an export-oriented one, and the economy became highly open to foreign trade. Figure 12 shows the openness trend of the Turkish economy

between the years 1990 and 2003. As seen in Figure 12, openness of the economy has increased significantly from 30% in 1990 to almost 50% in 2003. This increase in recent years can be explained by intense privatization of important government enterprises and assets, becoming a member of Customs Union and incentives given to the MNCs by the Turkish government.

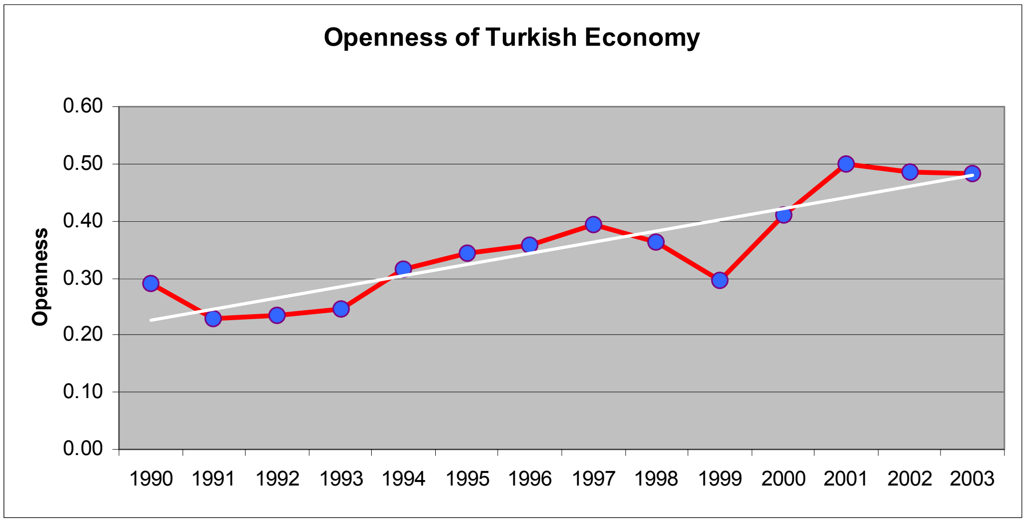

Figure 12. Openness of Turkish economy (Derived from www.dtm.gov.tr, www.deik.org.tr, www.geni.org date accessed 12/05/2004)

Intermodal Transportation Capability: Having coastal access, Istanbul provides all kinds of transportation modes in terms of logistics. Istanbul has one of the biggest and most modern airports in Europe. With its high-tech infrastructure, improved security systems, commodities, ease of customs process and large passenger capacity, Ataturk International Airport is a candidate for becoming an international hub airport for flight connections.

Intermodal connections between highways, railways, sea and air transportation can easily be done in Istanbul. This helps transportation of passengers, goods and supplies in a cost-effective and timely way in supply chains.

b. Weaknesses

Lack of Political and Economic Stability: Turkey has suffered from the lack of political and economic stability during the last two decades. Turkey’s political instability can be explained by the fact that the country has had 16 different governments

since 1980. These frequent government changes prevented necessary structural and economic reforms, and caused an unstable economic environment and hyperinflation in Turkey. According to the survey conducted by Loewendahl and Ertugal-Loewendahl (2001), 70% of the respondents cited political instability and 50% cited economic instability as key factors reducing the level of foreign direct investment in Turkey.

Traffic Congestion: As with every large city in the world, traffic congestion in Istanbul is a major concern. Although the municipality of Istanbul and the Turkish government implemented new regulations and IT systems, and increased traffic fines, congestion still remains as a problem. To solve this problem, the municipality acquired a modern traffic control system, utilizing a network that consists of strategically located, computer-controlled intersections throughout the metropolitan area, and by operators in the central office who can control traffic signals and reroute traffic by simultaneously monitoring and controlling all networked traffic intersections. Information gathered in the central office will be forwarded on to news and traffic information services and eventually be utilized in a GPS system that can assist individual drivers in choosing optimal routes to reach their specific locations. We believe that the new IT system will help the issue but its effects seem not to be seen in the near future due to the fast growing population and number of car owners in Istanbul.

Earthquake Risk: Istanbul, a metropolis with more than 13 million residents, is under constant threat of major earthquakes. Experts predict that a devastating earthquake could hit the city within two to three decades. If it does, it is likely to cause extreme loss of lives and property, given the fact that millions of inhabitants of Turkey's largest city live in areas considered to be at high risk. Seismologists expect a tremor of more than 7.0 on the Richter scale to hit the city in the near future. The mayor of Istanbul recently admitted that the city was unprepared for a major earthquake, blaming inadequate financial resources and public negligence for the poor state of preparation. The danger facing the metropolis first came to public attention in 1999 when two massive tremors hit Istanbul's vicinity, killing thousands of people and damaging hundreds of buildings. Figure 13 shows the earthquake risk map of Turkey. As seen on the map,

Istanbul is in category 1 and category 2 regions (categories are from 1 to 5, 1 being the most risky category).

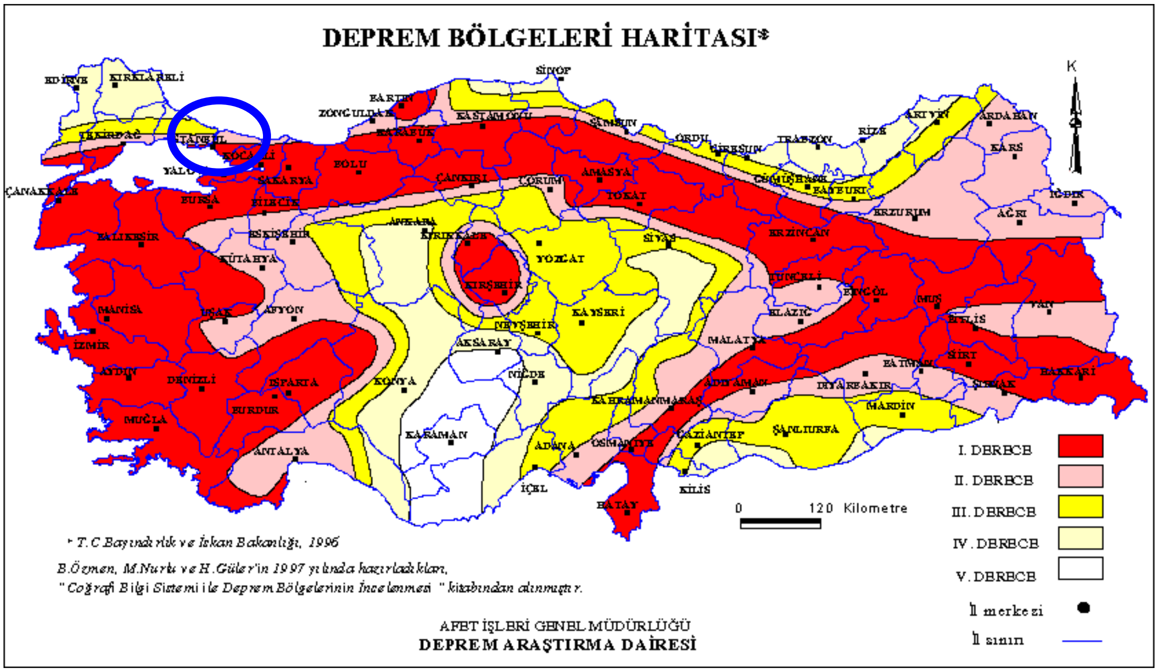

Figure 13. Earthquake risk map of Turkey (From www.e-sehir.com date accessed 12/05/2004)

Note: Risk categories are 1 (red), 2 (pink), 3 (yellow), 4 (light yellow) and 5(white). Category 1 is the most risky and Category 5 the least.

High Migration Rate: Istanbul is a place that attracts large numbers of refugees and immigrants from all over Turkey. The migration rate of Istanbul is 23 migrants per 1000 population per year. This relatively high migration rate worsens other problems of the city (e.g., congestion, overcrowding, illegal residence and unemployment).

Low Income Level Per Capita: Although Istanbul's GDP is very high compared to its competitor cities in the region (Warsaw, Prague and Budapest), due to its huge population, income level per capita in Istanbul is relatively low, and so is purchasing power.

c. Threats

Developing Competitor Cities in the Region: Istanbul faces both domestic and foreign competition in terms of attracting foreign investments. Recently

Izmir, Kocaeli and Mersin have become Turkey's major seaports ahead of Istanbul in terms of magnitude of maritime operations. These heavily industrialized major cities have the potential for becoming the business hub of Turkey in the future. On the other hand, major cities in the Eastern Europe are developing very fast and attracting more FDI compared to Istanbul. Especially since the Czech Republic, Hungary and Poland became members of the European Union in May 2004, Prague, Budapest and Warsaw have become more advantageous compared to Istanbul.

Potential Denial of EU Membership: According to Eurostat (1997: 39), "it is clear that European companies have a tendency to respond to globalization pressures by enhancing the division of labor through FDI within the EU rather than to third countries." Membership of the EU therefore makes a country more attractive for FDI from European companies (Loewendahl & Ertugal-Loewendahl, 2001). The case of Ireland and Portugal supports this statement. According to Thomsen and Woolcock (1993), Ireland's FDI from the United States doubled in the first five years of its membership, and Portugal's inward FDI flows doubled every year between 1987 and 1989 after it became a member in 1986.

Turkey is on the edge of becoming a member of the EU, but currently there are strong denial signs from some of the member countries, such as France, Denmark and Austria. At the moment intense negotiations are being held to convince these countries. We believe that a denial of Turkey for becoming a member state of the EU will negatively affect the attractiveness of Istanbul to foreign investors.

Terrorism in the Middle East: Global terrorism originating from the Middle East has been affecting many countries and MNCs in the world increasingly in the last decade. Being adjacent to the Middle East and having made big improvements towards Westernization, Istanbul has become one of the major targets for terrorists who do not want Istanbul to develop and become a business center in the region. Recent bombings in November 2003 especially chose foreign-owned buildings and facilities (HSBC Istanbul headquarters, a synagogue and the British Embassy) as targets in Istanbul. We believe that by doing so, these terrorists aimed to deter foreigners from investing in Istanbul.

d. Opportunities

EU Membership: We believe that becoming a member state of the EU will increase the attractiveness of Turkey and help creating a favorable FDI-enabling and political-institutional environment. "There are two key reasons why Turkey needs to join the EU as soon as possible if it is to become a center of gravity for inward (FDI) investment. First, the CEECs (Central and Eastern European Countries) that join the EU first are likely to further divert FDI away from Turkey. Second, Turkish products cannot compete on a level playing field unless Turkey is a member of the EU or Single European Market" (Loewendahl & Ertugal-Loewendahl).

Establishment of Peace in the Middle East: Turkey has suffered from terrorism in the last two decades. The terrorism, which originated in the Middle East, chose Turkey as a target and not only cost the lives of thousands of innocent people, but also affected the economy of Turkey severely. We believe that this deterred many MNCs from investing in, and many tourists from visiting, Turkey.

The conflicts in the Middle East caused Turkey to close the borders with Iraq, an important trade partner. The oil pipes carrying Iraq's oil to Turkey and from there to the world were closed. The cost of the first Gulf War to Turkey is estimated to be US$40 billion.

The establishment of peace and decontamination of the region from the terrorists will significantly have positive effects on Turkey's economic environment. Trade relationships with Middle Eastern countries will prosper again, and these markets will be accessible from Turkey.

Reconstruction of Iraq and Afghanistan: Major conflicts in Afghanistan and Iraq have almost ruined the infrastructures of these countries. A future reconstruction operation will create new business opportunities in the region, especially for construction, logistics, telecommunications and IT companies. We believe that Turkey (Istanbul) has a great chance of becoming the base for these operations and companies.

Relationships with Turkic Republics: Although Turkey has historical, cultural and religious ties with Turkic Republics (Azerbaijan, Uzbekistan, Kyrgyzstan, Turkmenistan and Kazakhstan), the economic and political relationships with these countries have not been at the desired levels. Considering the natural resources (oil and

natural gas reserves) and market potential available in these countries, improvement of economic and political relationships between both parties will be significantly beneficial for Turkey (Istanbul). We believe that improved relationships with Turkic republics will increase the attractiveness of Istanbul for market and resource-seeking foreign investors (MNCs).

A city controls only some of the factors which determine the attractiveness of the city for foreign investment. Political and economic stability is one of these factors that significantly affect the attractiveness of the city but are not controlled by the city itself. We believe that the attractiveness of Istanbul is directly affected by the strengths and weaknesses of Turkey. In 2001 Loewendahl and Ertugal-Loewendahl interviewed with 30 senior MNC executives to find out the strengths, weaknesses, threats and opportunities of Turkey in terms of FDI attractiveness. The following figures show the results of this survey.

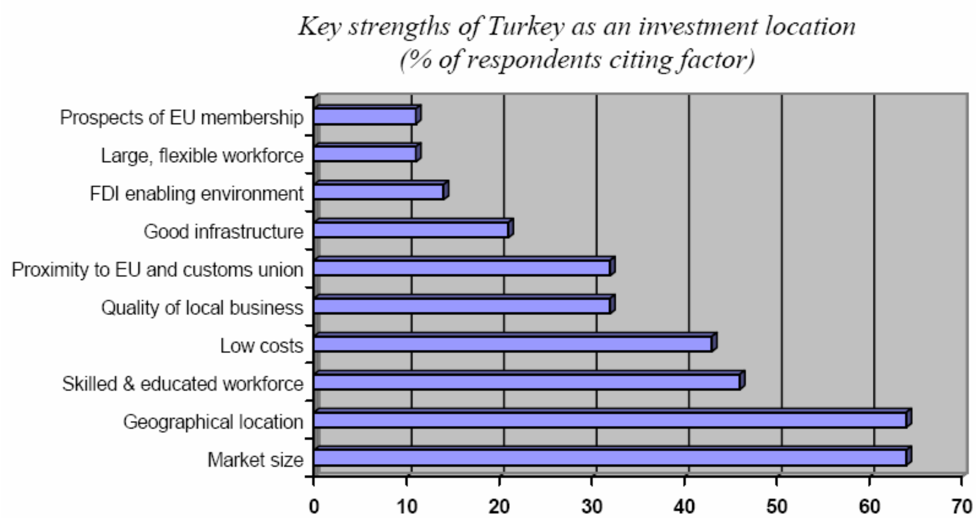

Figure 14. Key Strengths of Turkey as an Investment Location (From Loewendahl & Ertugal Loewendahl, 2001)

Figure 14 shows the key strengths of Turkey as an investment location. Market size and geographic location were cited as the most important strengths. Nearly 65% of the respondents cited these two factors as key strengths. Other strengths according to the respondents of the survey were, skilled and educated labor force, low costs, quality of

local business, good infrastructure, FDI enabling environment, and prospects of EU membership.

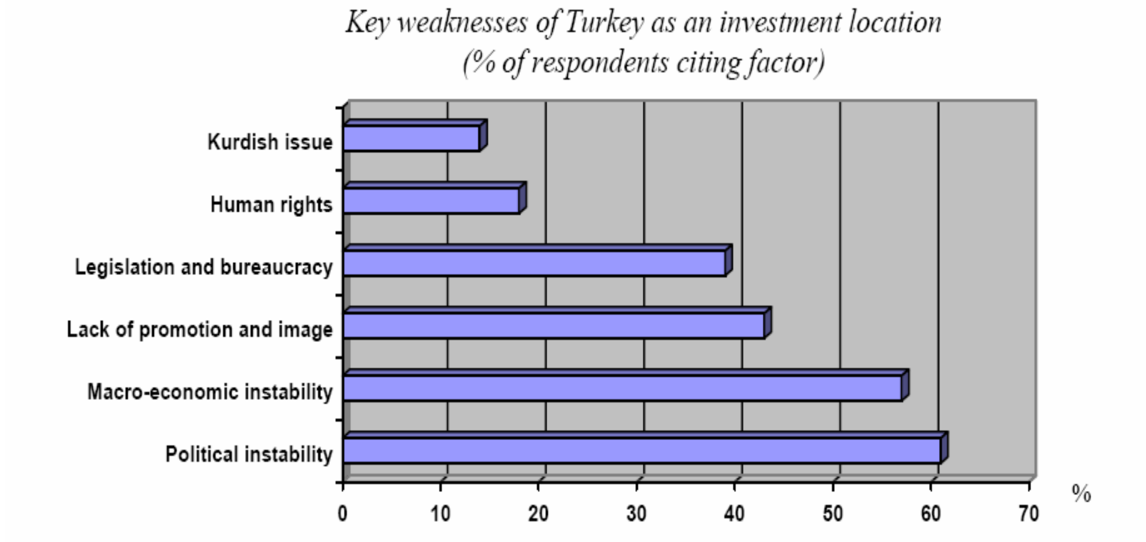

Figure 15. Key weaknesses of Turkey as an Investment Location (From Loewendahl & Ertugal Loewendahl, 2001)

Political and economic instability is cited as the most important weakness that deters FDI inflows. Other critical weaknesses are lack of promotion, and legislation and bureaucracy. Less than 20% of the respondents also cited human rights and Kurdish issue as weaknesses of Turkey as an investment location.

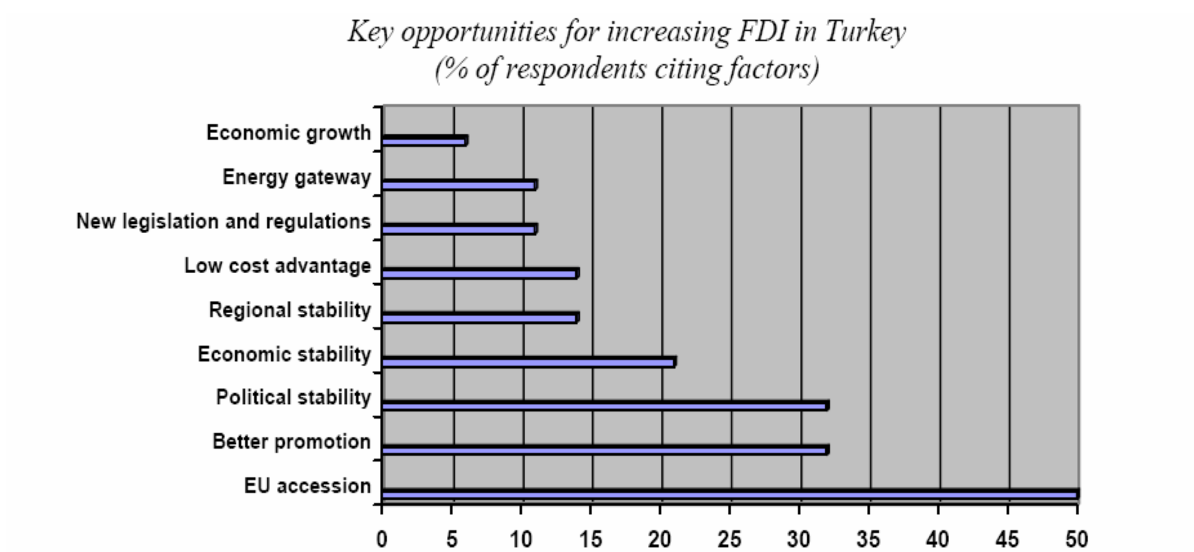

Figure 16. Key opportunities for increasing FDI in Turkey (From Loewendahl &

Ertugal Loewendahl, 2001)

EU accession, better promotion, and creating a more stable political and economic environment are seen as the most important opportunities for increasing FDI inflows into Turkey.

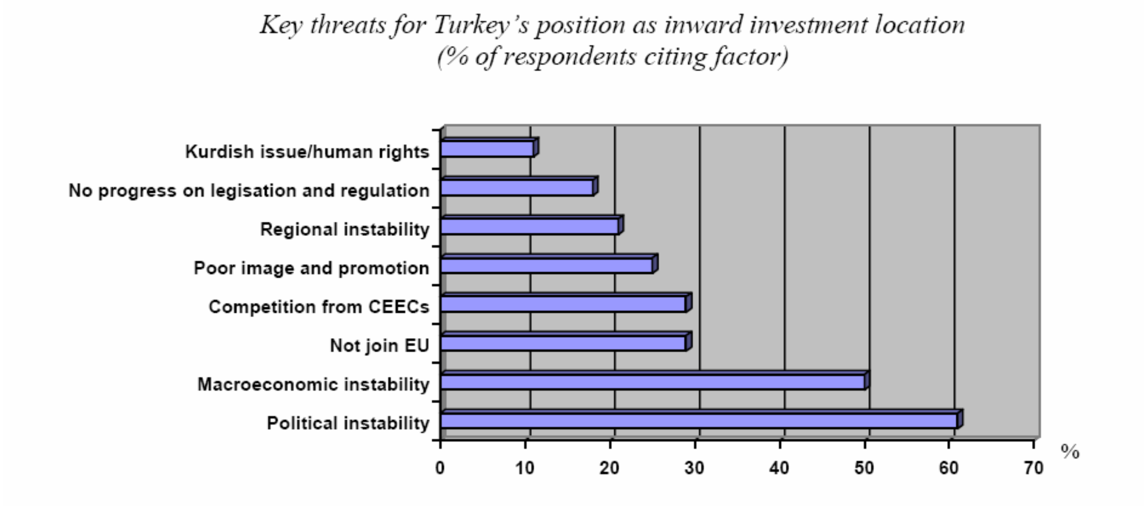

Figure 17. Key threats for Turkey's position as an Investment Location (From Loewendahl & Ertugal Loewendahl, 2001)

Respondents cited economic and political instability also as threats along with denial of membership from EU, intense competition in the region with CEECs and regional instability.

In this analysis we tried to assess Istanbul's local economic development by identifying its strengths (local assets), weaknesses (obstacles to growth), opportunities (favorable exogenous (external) conditions) and threats (unfavorable exogenous (external) trends).

Since this competitiveness assessment was undertaken as a free-standing activity, it should be used as part of Istanbul's developed strategic planning processes involving mission statements, scenarios, etc. This SWOT analysis will assist other analyst(s) in identifying realistic thrusts or niches for Istanbul to pursue in a competitive, conflict-ridden world under conditions of limited resources and rapid change.

This analysis only has value if progress is monitored. Every key element of the SWOT matrix should be keyed to one or more indicators, and every indicator should

relate back to a clearly stated action (policy, instrument, and project) in the strategy. In achieving Istanbul's competitiveness strategy, this analysis should be continuously upgraded so that every internal and external change can be taken into consideration.

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IV. CONCLUSION AND RECOMMENDATIONS

A. CONCLUSION

Globalization has prompted many big corporations to relocate their production, distribution, and other major operations into foreign countries to stay in the intense competition for manufacturing at lower costs and economies of scale, reaching the world's huge markets and getting access to the essential raw materials and natural resources available in these countries. This trend in the global economy has also created strong competition among developing countries that want to attract these critical and massive investments into their economies.

In this project we looked at how corporations decide whether or not to internationalize, how they choose a specific location (host country) as an investment location and what key determinant factors affect this decision-making process. To describe the decision-making process of MNCs for investing in foreign countries, we used the Eclectic Paradigm of Dunning (1979, 1980) in Chapter Two. According to the Eclectic Paradigm, there are three important factors that depict the internationalization process of MNCs: "ownership advantages," "internalization advantages" and "location advantages." In our analysis we focused on location factors to find out the determinants affecting the attractiveness of a host city or country for foreign direct investment.

Using the Value Net analysis we uncovered Istanbul's position in terms of attracting foreign investors, and with the SWOT (Strengths-Weaknesses-Opportunities-Threats) analysis we examined Istanbul's capabilities, advantages, weaknesses, threats and opportunities on its way to become a regional business hub. The results of our analysis reveal that Istanbul has a great potential for becoming a regional business hub for MNCs that want access to huge markets in Europe, Caucasia and the Middle East, as well as to the emerging market in Turkey itself. Istanbul possesses many advantages, along with some weaknesses that cause the inward FDI flows to remain at much lower than the desired levels. We find that huge market size, unique geographic location, availability of business-friendly customs service, favorable incentives offered by the

Turkish government to MNCs, a high-quality labor force, availability of land and expansion capabilities, attractiveness to tourists, a very open economy for foreign trade and availability of easy intermodal transportation connection capabilities are the essential advantages and strengths of Istanbul in terms of attractiveness for foreign investment.

Lack of political and economic stability is the most critical weakness and acts as an important deterrent for FDI inflows into the city. Other disadvantages are traffic congestion, overcrowded and unplanned population growth, the potential for devastating earthquakes, an uncontrolled and high migration rate and a low income level per capita in the city.

B. RECOMMENDATIONS

To receive the desired level of FDI inflows, first of all Turkey should dramatically improve the political and economic stability. As we stated in the previous chapters, this issue is the biggest obstacle facing the country in terms of attracting foreign investors. The governments should avoid populist policies and focus more on structural and economic reforms.

The main cause of Turkey's economic instability seems to be hyperinflation and ineffective monetary policies. After the severe economic crisis of 2000 and 2001, Turkey launched a successful reform drive, and performed a stunning achievement in terms of stabilizing and creating a functioning market economy. According to the latest OECD (Organization for Economic Co-operation and Development) report in October 2004, "A window of opportunity has opened for Turkey to shift its economy to a 'stronger and sustainable job-rich growth path'". The inflation rate was reduced to 12% (annualized) in the first half of 2004 (it was 54% per year in 2001 and 25% in 2003). Turkey should continue with these reforms and keep up the pace for creating a more stable economic and political environment. Even though the inflation rate has declined significantly during the last two years, the country's net debt-to-GDP ratio is still high (70%). This ratio should be reduced to at least 55% in the next 3-5 years (OECD, 2004).

Although some regulations have been introduced, and improved IT solutions have been implemented, traffic congestion remains a major chronic problem in Istanbul. The

municipality should continue to invest in new IT systems to monitor and control the traffic. Public transportation should be promoted. Current subway lines are insufficient. A master plan for improving and implementing more lines between both sides (Asia and Europe sides) of the city is needed. The two bridges connecting the two sides (European and Asian) are insufficient for the massive traffic flow from one to the other. Construction of another bridge or an underwater tunnel is necessary to ease the traffic burden on these existing two bridges. Railway connection between the two sides (Haydarpasa and Sirkeci) would create a great advantage in terms of intermodal connection.

The migration rate is still a big concern. The city is getting more and more overcrowded every year. We recommend a regulation for visa and residency permit requirements to monitor and control illegal and unplanned migration into the city from other cities in Turkey.

Istanbul needs to implement new regulations and improve current infrastructure to reduce the deadly effects of a possible major earthquake. Although the municipality has a master plan, the funds reserved for the plan are insufficient. Public awareness needs to be aroused. Currently there is an education campaign to teach citizens how to stay secure in case of an earthquake, but we recommend that the municipality and the Turkish government promote a campaign to teach precautionary measures required before a major earthquake to minimize the aftereffects.

Istanbul also lacks an image for business. The commercial campaign—"I dream of Istanbul"—currently shown on domestic TV channels should be promoted also in foreign countries. Since this campaign focuses on tourism, we recommend that economic and business campaigns should also be promoted to create a business-friendly image of the city.

Metropolitan areas are now the arenas of global interaction. Istanbul is in the process of transformation towards becoming a global city. This development will only take place with evolving competitiveness strategies that include suitable assessments and analyses.

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